CONSUMERS SHORTCHANGED? OVERSIGHT OF THE JUSTICE DEPARTMENT'S MORTGAGE LENDING SETTLEMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON
REGULATORY REFORM,
COMMERCIAL AND ANTITRUST LAW

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

FEBRUARY 12, 2015

Serial No. 114–16

Printed for the use of the Committee on the Judiciary

Available via the World Wide Web: http://judiciary.house.gov

U.S. GOVERNMENT PUBLISHING OFFICE

93–280 PDF WASHINGTON : 2015

For sale by the Superintendent of Documents, U.S. Government Publishing Office
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CONSUMERS SHORTCHANGED? OVERSIGHT OF THE JUSTICE DEPARTMENT'S MORTGAGE LENDING SETTLEMENTS

THURSDAY, FEBRUARY 12, 2015

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON REGULATORY REFORM,
COMMERCIAL AND ANTITRUST LAW
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:32 a.m., in room 2141, Rayburn Office Building, the Honorable Tom Marino (Chairman of the Subcommittee) presiding.

Present: Representatives Marino, Goodlatte, Collins, Ratcliffe, Trott, Bishop, Conyers, and Jeffries.

Also present: Representative King.

Staff present: (Majority) Dan Huff, Counsel; Andrea Lindsey, Clerk; and (Minority) Slade Bond, Counsel.

Mr. MARINO. The Subcommittee on Regulatory Reform, Commercial and Antitrust Law will come to order. Without objection, the Chair is authorized to declare recesses of the Committee at any time.

We welcome everyone to today's hearing on Consumers Shortchanged? Oversight of the Justice Department's Mortgage Lending Settlements. I will recognize myself for a brief opening statement.

Welcome to this hearing entitled "Consumers Shortchanged? Oversight of the Justice Department's Mortgage Lending Settlements." At issue are DOJ's high profile settlements with JPMorgan, Citi, and Bank of America over their activities related to the financial crisis. The Committee is concerned that too much of the settlement money is not making it directly to consumers genuinely harmed.

The Citi and Bank of America settlements require the banks to donate at least $150 million and as much as over a half billion dollars to activist groups. To be sure, those groups do engage in housing counseling and related activities, but those activities are most helpful to families still in their homes. What about the millions of Americans who have already lost their homes?

I know the Department of Justice responds that the mandatory donation provisions represent only a small portion of the consumer relief packages which total in the billions, but tell that to Jeff and Robin Brown. After the Chrysler plant in Newark, Delaware closed

in 2009, they fell on hard times. Frustrating attempts to renegotiate their mortgage with Citi was were fruitless. They lost $3,000 to a loan assistance scam, then they received an eviction notice.

The request for two extra weeks so Robin could recover from a setback with her multiple sclerosis was denied. So they looked at what they could and they took what they were able and departed the home they had saved for and lived in for 8 years. As a result of the settlement, they got a check from Citi for $500.

Their experience is detailed, along with others, in a Delaware online story titled "Some Who Lost Homes Feel Forgotten in Foreclosure Settlements." They are upset that the State of Delaware is poised to spend the remaining $36.6 million on community service projects instead of actual victims. I want to know why DOJ did not do more to ensure that States receiving settlement money put victims before pet projects.

The evidence is not nearly anecdotal. The story noted that of 32,000 homeowners foreclosed upon, only about a thousand ever received compensation. Most checks were for less than $1,500. That is just in Delaware. Since 2008, there have been 4.9 million foreclosures nationwide. It is a cruel irony that those who have lost the most to the foreclosure crisis seem to be helped the least from DOJ settlements.

Loan modifications cannot assist those already evicted. They should have the strongest claim to the limited amount of hard dollars that the banks are paying out. Instead, the cash is going to activist groups because they work with victims of the housing crisis. I guess this means the Administration does believe in trickle-down economics so long as the money is trickling through activist groups. I hope these groups at least do good work because Congress already funds some of them through Federal grants.

But therein lies another problem. It is the role of the Congress, not the executive, to allocate funds. This is a core feature of our constitutional system of separation of powers. James Madison called Congress' appropriations power "the most effectual weapon." He noted it was the power of the purse that allowed the British Parliament to reduce "the overgrown prerogatives of the other branches of government."

Also oversight is lacking. For example, the Legal Services Corporation, which provides funding for legal aid, has a dedicated oversight section to monitor grantees. The bank settlement provides no such oversight to ensure the recipient of donations use them as intended. If the money is not being used to lift up those most affected by the housing crisis, should we not at least be concerned about how it is spent? In short, the mandatory donation provisions also raise a host of legal and policy issues, including potential violations of the Miscellaneous Receipts Act and internal DOJ policies.

I thank Deputy Assistant Attorney Graber and all of our witnesses for attending, and I look forward to the discussion. Unfortunately, my good friend, Mr. Johnson, is not here today because he has the flu, and he is the Ranking Member of the Subcommittee. But we are also honored and fortunate enough to have the Ranking Member of the full Committee, Mr. Conyers. So I am now going to ask Mr. Conyers to make an opening statement if he wishes to.

Mr. CONYERS. Thank you, Mr. Chairman. I do wish to. Members of the Committee, the stated purpose of today's hearing is to determine whether there has been a misuse of mortgage settlement funds by the Administration for its so-called "pet projects." In truth, however, this really is a hearing, a misguided hearing, a witch hunt, that has absolutely nothing to do with helping the millions of hardworking Americans who were swindled by unscrupulous and predatory mortgage lenders and mortgage services. Nor does it have anything to do with addressing the massive fraud committed by the securities industry that nearly led to the financial collapse of our Nation's economy.

Rather than focus on these critical issues, the majority has cited the so-called activist organizations and the Justice Department as the perpetrators worthy of this hearing. And who exactly are these entities? They are housing counseling programs administered at national, State, and local levels by service providers subject to a rigorous certification process by the United States Department of Housing and Urban Development. They include such organizations as the New York State Office for People with Developmental Disabilities, the Michigan State University Extension Service, the New York City Commission on Human Rights, and NeighborWorks America.

So let us take a look in depth at one of these organizations. NeighborWorks is chartered by Congress. Its board of directors, whose membership is determined by statute, consists of the heads of the financial regulatory agencies, who are presidential appointees subject to Senate confirmation. In fact, Congress in 2007 designated NeighborWorks America to administer the National Foreclosure Mitigation Counseling Program pursuant to which this organization has helped more than 1.725 million homeowners. That is almost 2 million homeowners.

If the majority really cared about the victims of the foreclosure crisis, we would be holding a hearing on either the mortgage crisis that still grips many parts of our Nation, or on how Congress could better assist those millions of Americans who still are at risk of losing their homes. Now, in stark contrast, when I was Chairman of this Committee, we held nine hearings and two field briefings examining the causes and impact of the foreclosure crisis as well as potential solutions. Over the course of those hearings, the Committee heard from a United States senator, various Members of the House, representatives from the Treasury Department, the Comptroller of the Currency, the Federal Housing Finance Agency, bankruptcy judges, nationally recognized economists, leading academics, victims of predatory mortgage lending, and many more voices.

Finally, I am particularly concerned that the majority has unfairly singled out the National Council of La Raza, which is the Nation's largest Hispanic civil rights and advocacy organization. The Chairman of this Committee and the Chairman of the Financial Services Committee in a letter to the Justice Department last November characterized La Raza as "activist group that stands to benefit from the mortgage settlement agreements with Citicorp and the Bank of America." As detailed in a response from La Raza, which I ask unanimous consent to include in today's hearing record, there is absolutely no truth to this allegation.

[The information referred to follows:]

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February 11, 2015

The Honorable Tom Marino
410 Cannon House Office Building
Washington, DC 20515

The Honorable Hank Johnson, Jr.
2240 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Marino and Ranking Member Johnson:

On behalf of the National Council of La Raza (NCLR), the largest national Hispanic civil rights and advocacy organization in the United States, I write in regard to an upcoming hearing of the Subcommittee on Regulatory Reform, Commercial and Antitrust Law of the House Judiciary Committee, titled "Consumers Shortchanged? Oversight of the Justice Department's Mortgage Lending Settlements." While NCLR has not been contacted by anyone from the majority regarding this hearing, we want to take the opportunity to inform you about NCLR's long and distinguished work in the housing arena to correct some inaccuracies and misconceptions that have appeared in the media.

NCLR proudly represents nearly 300 Affiliates—community-based organizations in 41 states, the District of Columbia, and Puerto Rico—that provide education, health, housing, workforce development, and other services to millions of American families annually. As an American institution recognized in the book *Forces for Good* as one of the best nonpartisan, nonprofit organizations in the nation, we strive to strengthen our country by promoting the advancement of Latino families.

At the outset, I wish to note that what follows speaks solely to our historical work in the housing arena. While we are aware that we are included in a list of potential grantees in the Citibank and Bank of America settlements, along with every other national intermediary certified by the U.S. Department of Housing and Urban Development (HUD), we have not received any monies to date from either of these entities related to these settlements, nor have we been notified by either of these companies or the Department of Justice that we will be receiving funding.

Housing has long been a priority for our organization, since homeownership remains the cornerstone of achieving prosperity and securing the American Dream. For most Americans, a home is the largest asset that a family will ever own. Obtaining such an asset translates into major benefits for the family, their community, and the national economy. Creating homeownership opportunities in low- and moderate-income Latino communities has thus been a priority of NCLR's for more than a decade. For the last 13 years, NCLR has operated the NCLR Homeownership Network, which is composed of 49 community-based housing counseling providers that work with over 50,000 families annually. These organizations have helped more than 30,000 families become first-time homebuyers since the inception of the network.

In recognition of our standing as the largest provider of housing counseling in the Latino community, NCLR became one of HUD's Housing Counseling Program national intermediaries in 1997–1998. HUD maintains comprehensive, stringent standards on how housing counseling is conducted and must certify all agencies that receive funding. To ensure compliance, HUD audits housing counseling agencies every two years to measure adherence to their standards. Only audited agencies or agencies within intermediary networks are deemed "HUD-certified" and therefore eligible for funding.

As a certified intermediary, we support our Affiliates by providing quality control and training, assisting in building capacity, facilitating industry partnerships, pioneering products, and offering technology support. NCLR also distributes funding to our housing-focused Affiliates through grants from federal and corporate sources that are based on work plans, goals, and outcomes. All organizations compete for this funding annually to ensure that counseling services reach new communities and promote the strong work of the nonprofits that serve them.

NCLR's network of expert housing counselors—and all HUD-certified housing counselors—play a crucial role as third parties that offer unbiased information and advice to homebuyers, renters, victims of predatory lending, and families facing a financial emergency. NCLR's network of housing counselors emphasizes in-person, one-on-one counseling that has proven more effective at generating positive outcomes for Latino families. For some, a housing counselor has made the difference between unnecessary foreclosure and keeping a home.

The work of the NCLR Homeownership Network could not be more important, as families continue to recover from the wealth they lost during the foreclosure crisis. As you may know, communities of color, and the Latino community in particular, were hit hardest by this crisis. For example:

- Hispanic families lost 44% of their wealth between 2007 and 2010; by contrast, White families lost 11%.
- From 2005 to 2009, the median level of home equity held by Latino homeowners declined by half—from $99,983 to $49,145. At the same time, homeownership rates among Hispanics also fell, from 51% to 47%.
- A disproportionate share of Hispanics live in California, Florida, Nevada, and Arizona, states that experienced the steepest declines in housing values during the crisis.

The U.S. Department of Justice settlement agreements with various financial institutions in part indicate why this may have been the case. These settlements found that mortgage lenders often targeted Latinos and other minority borrowers with unsafe and predatory products. As a remedy, a small fraction of the overall payments in these settlements was dedicated to certified housing counseling intermediaries, given the known success of counselors in helping families remain in their homes.

One example is a Georgia-based organization that is a member of the NCLR Homeownership Network, Dalton-Whitfield Community Development Corporation, Inc. (DWCDC). This organization provided foreclosure prevention counseling to help a family secure a loan modification on a subprime, high-interest loan after the family was denied several times by the bank. Administrative errors on the part of the servicer, such as losing documents and revolving points of contact, made the process unmanageable for the family over a two-year period. The family eventually received a modification due to a DWCDC counselor's intervention with the servicer. The housing counselor also continued to assist the family in managing communications with the lender and creating a crisis budget to save for future emergencies. There are countless examples like this from NCLR and other counseling organizations in which housing counselors help families confront lengthy and complex processes and work with unresponsive banks—issues that are all the more complicated when there are language barriers. This example is illustrative of what we know to be true: housing counseling works.

The September 2014 NeighborWorks America evaluation for the National Foreclosure Mitigation Counseling (NFMC) program (for the period July 2009–June 2012) showed that homeowners are 2.83 times more likely to get a modification if they receive housing counseling. As a result, over 96,000

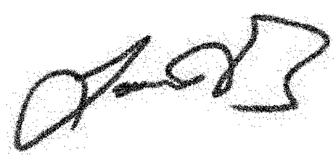
NFMC clients secured a loan modification through housing counseling—modifications that they could not have secured on their own—saving them about $478 million annually. The combined effect of monthly loan payment reduction and counseling assistance also reduced, by approximately 70%, the odds that a borrower would return to troubled loan status after receiving a loan modification. Virtually all of the improvement in sustained loan performance was a result of NFMC counseling, during which clients received help to improve their financial management skills and manage relationships with servicers and investors, among other types of support.

Policymakers on both sides of the aisle have recognized the value of pre- and post-purchase counseling. Former Congressman James Walsh (R–NY) played an instrumental role in allocating funding to housing counseling, and former Senator Kit Bond (R–MO) has written a number of blog posts and editorials through his work with the Bipartisan Policy Center on the importance of early intervention to forestall financial disaster. These are just two examples out of many who have spoken about housing counseling's demonstrable benefit.

As a civil rights and advocacy organization, NCLR recognizes that some may disagree with the policy positions we have taken. However, we hope we can all agree that preventing foreclosure and keeping families in their homes are critically important to stabilizing our nation's economy. I hope this letter puts to rest any confusion about the role of the NCLR Homeownership Network and clarifies our ongoing work to help homeowners.

My staff are willing to answer any questions you may have. Please contact Lindsay Daniels, Manager of NCLR's Wealth-Building Initiative, at 202.776.1704 or ldaniels@nclr.org for additional information.

Sincerely,



Lautaro "Lot" Diaz
Vice President,
Housing and Community Development

cc: Congressman Jeb Hensarling
Congressman Bob Goodlatte

Regional Offices: Chicago, Illinois • Los Angeles, California
Miami, Florida • New York, New York • Phoenix, Arizona • San Antonio, Texas

Mr. CONYERS. In fact, La Raza has not received a single penny from these settlements, and it did not proactively seek to be designated as a recipient of these funds. La Raza is not even named specifically in either of these settlement agreements as a designated recipient. And if it was to receive any monies under these agreements, La Raza has a firewall between its housing counseling activities and its advocacy activities, as well as accounting standards in place to ensure such a separation. This information was readily available had the majority simply reached out to La Raza to confirm its allegations before putting them in writing to the Justice Department.

Thank the witnesses for joining us here today, and, Mr. Chairman, I yield back the balance of my time.

Mr. MARINO. Thank you, Congressman Conyers. It is my pleasure now to recognize the Chairman of the full Judiciary Committee, the gentleman from Virginia, Congressman Goodlatte, for his opening statement.

Mr. GOODLATTE. Thank you, Mr. Chairman. This hearing opens a pattern or practice investigation into the Justice Department mortgage lending settlements. The concern is that DOJ may have systematically subverted Congress' budget authority by using settlements to funnel money to activist groups. The evidence is a progression of startling terms in the DOJ's mortgage banking settlements. It began with the JPMorgan settlement that merely offered credit for donations to community redevelopment groups. Next came Citi and Bank of America settlements requiring $150 million in donations to housing nonprofits.

These donations earned double credit against the banks' overall obligations. Meanwhile, credit for direct forms of consumer relief remain dollar for dollar. Bank of America's settlement also required it to set aside $490 million to pay potential consumer tax liability arising from loan modifications. Should Congress again extend the non-taxable treatment of home loan forgiveness, the money does not revert to the bank. Instead it flows to activist groups, like NeighborWorks America, which has been described as funding "a national network of left wing community organizers operating in the mold of ACORN."

All told, DOJ has directed as much as half a billion dollars to activist groups entirely outside of the congressional budget and oversight process. DOJ will say that the groups receiving donations provide relief to homeowners. Even assuming this housing-related work is entirely non-partisan, money is fungible. Donations to the housing arm of any recipient would free up funds for the recipient to engage in more controversial activism in other areas. Furthermore, the Miscellaneous Receipts Act, or MRA, requires that money received by the government from any source be deposited in the Treasury. Directing a defendant to pay money directly to a third party interest group is simply an end run around the law.

DoJ's own internal guidance documents acknowledge the potential for abuse when settlements require donations to third parties. The U.S. Attorney's Manual says that the practice is restricted because it can create actual or perceived conflicts-of-interest and/or other ethical issues. It was almost entirely banned in 2008 due to instances of perceived abuse.

Exception was made for environmental settlements in view of robust guidance issued by DOJ's Environment and Natural Resources Division. However, to the extent that guidance is the basis for an exemption, DOJ's banking settlements violate it. The guidance requires a mechanism to ensure that any party receiving the funds spends them in a manner consistent with the intent of the community service requirement. There is no such oversight in the DOJ's banking settlements. The monitor is responsible only for the bank's compliance, not how the activist groups who receive donations use them. Related guidance also caps credit for donations to community service projects at dollar for dollar.

Even more troubling, the guidelines state that community service cannot be of such a nature that it provides additional resources for the performance of an activity for which Congress specifically has appropriated funds. This ensures that the settlement does run not afoul of the Miscellaneous Receipts Act by unilaterally augmenting a congressional appropriation.

Congress specifically funds the Department of Housing and Urban Development's Housing Counseling Assistance Program. In a press release, La Raza, one of the largest grant recipients under the program, lamented that Congress cut funding from $88 million to $45 million. It subsequently praised DOJ bank settlements, which required $30 million in donations specifically to HUD-approved housing counseling agencies. Thus, DOJ's settlements appear to restore most of the funding that Congress specifically cut.

For DOJ to funnel money to third parties through settlements this way may violate the law and is undoubtedly bad policy. The purpose of enforcement actions is punishment and redress to actual victims. Carrying that concept to communities at large or activist community groups, however worthy, is a matter for the legislative branch and is not to be conducted at the unilateral discretion of the executive.

I thank all of our witnesses for appearing and look forward to their testimony today. Thank you, Mr. Chairman.

Mr. MARINO. Thank you, Chairman. Without objection, other Members' opening statements will be made part of the record.

And now just to do some little detail work, I think Mr. Conyers wants to enter something in the record.

Mr. CONYERS. Yes. I would like to put our colleague, Hank Johnson's, statement in the record. And I ask unanimous consent to have his statement put into the record, please.

Mr. MARINO. Without objection, so ordered.

[The prepared statement of Mr. Johnson follows:]

Prepared Statement of the Honorable Henry C. "Hank" Johnson, Jr., a Representative in Congress from the State of Georgia, and Ranking Member, Subcommittee on Regulatory Reform, Commercial and Antitrust Law

Thank you, Chairman Marino.

Built on the back of predatory loans, toxic mortgage securitization, and regulatory failure, the mortgage-foreclosure crisis has blighted entire cities across the country while destabilizing the home market and countless other industries.

But the effects of foreclosures go far beyond simple economics.

Since the start of the Great Recession, foreclosures have sent shockwaves throughout entire communities, taking children out of schools, pulling families and friends apart, undermining religious congregations, and creating other forms of social instability.

Although recent data indicates that the foreclosure-filing rate is dropping to its lowest level since 2006, these positive figures do not capture the continued hardship of low-income and minority and households, which lag far behind national homeownership rates. Andrea Levere, the president of the Corporation for Enterprise Development, notes that this trend threatens "to exclude an increasing percentage of Americans from our mainstream financial systems."

We can't allow this to happen.

It is therefore incumbent on the federal government to not only hold fraudulent corporations accountable, but to also require that they meaningfully help the millions of consumers they harmed.

Today's hearing concerns settlement agreements between the Justice Department and JPMorgan, Citigroup, and Bank of America—companies that each admitted to fraudulently packaging, marketing, and selling residential-mortgage back securities, even where the banks knew the loans were defective.

These settlements amply demonstrate the fraud that pervaded every level of the securities industry, fraud that substantially contributed to the mortgage-foreclosure crisis and recession.

In addition to significant civil penalties, each of these agreements contains consumer-relief provisions designed to provide much-needed relief to millions of Americans affected by the fraudulent sale of toxic securities. These provisions of the agreement require the banks to provide billions in first-lien principal forgiveness to help families who are underwater on a mortgage to stay in their homes.

When homeowners fall behind in their mortgage payments, it is often a major task to bring them current. For that reason alone, mortgage modifications—such as those under the settlement agreements—are a standard tool to bring homeowners in good standing with their home loan and stop the foreclosure process.

Educating and assisting consumers is also a critical tool in foreclosure prevention. The Department of Housing and Urban Development (HUD) has documented that if a consumer works with a HUD-approved housing counseling agency, the odds of a favorable outcome are almost two-times greater.

Two of the Justice Department's settlements also require the settling banks to donate funds toward neighborhood reinvestment activities, which include donations to HUD-approved Housing Counseling Agencies, state-based Interest on Lawyer Trust Accounts organizations, and Community Development Financial Institutions.

Housing counseling agencies offer a critical education component to helping consumers avoid default and foreclosure by identifying the documents the mortgage company needs from the homeowner and contacting the mortgage company on the homeowner's behalf.

As we search for ways to avoid another mortgage crisis while repairing the incalculable damage that has already occurred, it is essential that we use every tool to keep families in their homes.

Although I wish that the Justice Department's settlements had required more of the banks that contributed directly to the plight of so many, I am confident that these agreements will do much to help millions of consumers across the country.

I yield back.

Mr. CONYERS. Thank you.

Mr. MARINO. And I am asking unanimous consent to enter into the record the following: number one, a letter to the Committee from the predominant legal scholar, Richard A. Epstein, outlining his view that appropriations to community groups should not be made part of the settlement process; number two, a statement for the record from the U.S. Chamber of Commerce and the U.S. Chamber Institute for Legal Reform noting that directing private parties to make payments to other private parties as part of settlement is, in effect, creating a Federal grant program that is administered by the agencies without statutory authorization; and finally, number three, a memo from the organization, Cause of Action, entitled "Investigation of Bank of America Settlement Receipts, NeighborWorks America."

Hearing no objections, so ordered.

[The information referred to follows:]

Richard A. Epstein
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February 9, 2015

The Honorable Bob Goodlatte
Chairman
Committee on the Judiciary
U.S. House of Representatives
Washington, DC 20510

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
Washington DC 20510

Re: Mortgage Lending Settlements of the Department of Justice with JP Morgan, Citigroup and Bank of America.

Dear Chairman Goodlatte and Chairman Hensarling:

This past week I was asked by Mr. Daniel Huff, Counsel in the House Judiciary Committee, to comment on some key features of the settlements that the Department of Justice has entered into with the three above-referenced banks. These transactions have been subject to an exchange of letters between Chairmen Bob Goodlatte and Jeb Hensarling and Peter J. Kadzik of the Department of Justice. In their letter of November 25, 2014, Chairmen Goodlatte and Hensarling asked very specific questions about the above referenced settlements. I do not think that these queries were fully and accurately answered by Mr. Kadzik's letter of January 6, 2015.

Before I address the arguments raised in this exchange of letters, I should state at the outset that in this matter I do not represent any client interest. I am writing this short because I had to decline Mr. Huff's invitation to testify at a planned Committee hearing later this week. My views on this question have been formed by extensive work that I have done both on financial regulation of the mortgage markets and, separately, on civil settlements and deferred prosecution agreements. I should also add that presently I am a professor of law at New York University Law School, a senior fellow at the Hoover Institution, and a senior lecturer, and professor emeritus at the University of Chicago. My letter in this case is written in a purely personal capacity and in no way represents or reflects the views of any of these three institutions.

The initial letter in this exchange from Chairmen Goodlatte and Hensarling, written on November 25, 2014 asked the DOJ to explain key provisions of the settlements that were recently entered into with Bank of America (BoA) and Citigroup. The source of their inquiry was that these settlements contained provisions that the settling banks go donate "$150 million to activist groups like La Raza and NeighborWorks" to assist community organizers. No similar provision was found in the earlier settlement with J.P. Morgan. Under the BoA and Citigroup settlements any dollars spent on these programs receive a two-dollar credit against their "overall consumer relief commitment," which necessarily gives the banks a financial incentive to take advantage of the stated credit to reduce their overall financial exposure. The Goodlatte-Hensarling letter then closes by making five specific requests about the people and processes that were involved in fashioning the BoA and Citigroup settlements.

The response from Mr. Kadzik defends the substantive terms of the BoA and Citigroup settlements, and then closes with a short paragraph that indicates that the settlement was negotiated "in good faith with the banks, who were represented by counsel." That paragraph states further that the terms of both settlements "were not dictated by the White House or any outside entity." Let me comment on the merits of the DOJ contentions.

As an initial observation, regardless of the merits of the basic payments to consumers under these settlements, the point of contention is solely the diversion of large sums of money from consumers to community groups who were not injured by any bank behavior. Institutionally, these are substantive appropriations to parties unrelated to the litigation that should only be made through the ordinary legislative process, after deliberation and debate in Congress. The DOJ settlement impermissibly short-circuits that entire political process, thereby allowing the DOJ to go beyond its own proper litigation role.

The shortfalls in the DOJ's processes are evident from the unsatisfactory response that Mr. Kadzik gives to the five specific questions on process contained on pages 2 and 3 of the Goodlatte/Hensarling letter. Their questions all asked which parties in and out of government "were involved" in the DOJ's decision to abandon the settlement format used in the JP Morgan case in both the BoA and Citigroup settlements. That concern is a valid one because it is always a dangerous practice to allow parties outside the DOJ to influence the terms of settlement. Evidently, any party that can so benefit has a built-in incentive to urge DOJ to push hard in litigation to generate some future collateral benefit.

These concerns have been evident in other cases. It was for precisely this reason that I publicly opposed the deferred prosecution agreement that then U.S. Attorney for New Jersey, Christopher J. Christie entered into with Bristol-Myers-Squibb, which contained a provision that required B-M-S to "endow a chair at Seton Hall University School of Law" Mr. Christie's alma mater, for teaching of business ethics. See Richard A. Epstein, The Deferred Prosecution Racket, The Wall Street

Journal, November 28, 2006, available at http://www.wsj.com/articles/SB116468395737834160. The great risk of course is that many institutions, not just Seton Hall, will press government lawyers to supply them with a share of the financial gains, and, perhaps, urge them to pursue aggressively the underlying civil or criminal investigation or litigation. The same risk is even greater in high stakes litigation like the DOJ actions against BoA and Citi.

The answers that Mr. Kadzik gives do not offer any concrete information on how best to deal with these risks. The DOJ should have addressed each of the five separate inquiries explicitly. Instead, Mr. Kadzik's brief penultimate paragraph offers only an evasive denial. The questions of the Goodlatte/Hensarling letter never asked whether the White House or any outside entity "dictated" settlement terms. Every one knows that they did not. The relevant questions are these. Who were the persons who made the decision to deviate from the settlement formula used in the J.P. Morgan case. Were there either White House or outside entities who *influenced* the outcome by inserting themselves into the settlement process Mr. Kadzik's does not deny that involvement took place. Nor does his letter respond to questions 2 or 3, by naming any particular parties from either the non-profits or the White House who may have been involved in structuring the settlement.

Nor is it responsive to the Goodlatte/Hensarling letter to note that the banks were represented by outside counsel. The simple point here is that on this issue the banks are not adverse to the DOJ. Indeed, both BoA and Citigroup have every incentive to accept terms that give them a two-for-one credit for any money that is paid out, even indirectly, to various advocacy groups. Their interest lies in reducing their total settlement costs. They do not care who gets the money. The two-for-one credit achieves exactly their preferred result.

Mr. Kadzik's letter also seeks to distance the DOJ from the two-for-one payment process by noting that "the banks are responsible for choosing specific recipients of consumer relief funds." But that observation does not answer the fourth question of whether the DOJ or the White House offered guidance to BoA and Citigroup at any time during this process. The fact that the banks funneled settlement dollars through organizations on lists approved by the DOJ does not eliminate the institutional risks involved in this case. Indeed, the specifics that deal with "donations to capitalize certified Community Development Financial Institutions" appear to limit distributions to parties on an approved list maintained by the Department of Treasury. With all these built-in settlement constraints, it seems highly likely that many settlement funds did in fact go to groups like La Raza or NeighborWorks. It would be perfectly reasonable for Chairmen Goodlatte and Hensarling to ask DOJ to supply a list of the grantees from these settlements if that information is not otherwise publicly available.

In sum I think that all appropriations to community groups should not be made part of the settlement process, as has happened in this case. Mr. Kadzik's

letter has done nothing to allay my concerns I have not formed any opinion on what response Congress should make toward these actions.

Sincerely yours,

Richard A. Epstein

Statement of the U.S. Chamber of Commerce

ON: Government Settlement Practices and Enforcement Slush Funds

TO: U.S. House of Representatives Committee on

The Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law

1615 H Street NW | Washington, DC | 20062

Statement for the Record Provided by

The U.S. Chamber of Commerce and the U.S. Chamber Institute for Legal Reform

To the Subcommittee on Regulatory Reform, Commercial, and Antitrust Law of the House Committee on the Judiciary

Hearing on "Consumers Shortchanged? Oversight of the Justice Department's Mortgage Lending Settlements"

February 12, 2015

This statement is being provided by the U.S. Chamber of Commerce (the "Chamber") and the U.S. Chamber Institute for Legal Reform ("ILR"). The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than three million companies of all sizes, sectors, and regions, as well as state and local chambers and industry associations, and dedicated to promoting, protecting, and defending America's free enterprise system. ILR is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, fairer, and faster for all participants.

The Chamber and ILR applaud the Subcommittee for holding this hearing regarding the federal government's practices in connection with settlements of enforcement proceedings. The Constitution vests Congress with authority to control and direct the spending of public resources. Federal agencies are circumventing this clear command by directing private parties to make payments to *other private parties* as part of settlement—in effect creating a federal grant program that is administered by the agencies without statutory authorization. Simply put, there is no statutory or constitutional basis for allowing federal Executive agencies to selectively distribute public funds to favored private parties.

These unauthorized and unchecked activities by federal agencies do not simply undermine the structure specified in the Constitution. They also create perverse incentives for agency officials to pursue enforcement activities that are based not on the public interest, but on the individual officials' narrow private interests in obtaining funds for favored private parties.

Indeed, the government frequently imposes these financial requirements as the price of settlement—and private parties often are forced to settle, regardless of the merits of the government's underlying claims, in order to avoid the brand and reputational damage that may result from an indictment or lengthy litigation. Here are just a few examples:

- The Justice Department in 2012 required the Gibson Guitar Corporation to make a \$50,000 "community service payment" to the National Fish and Wildlife Foundation ("NFWF"), even though that entity was not a victim of and had no direct relationship to the alleged offense—the claimed violation of a restriction on wood imports.[1]

[1] *See* Paul J. Larkin, "Funding Favored Sons and Daughters: Nonprosecution Agreements and 'Extraordinary Restitution'," 47 Loy. L. Rev 1, 6-7 (2013).

- British Petroleum was obligated to "donate" nearly $2.5 billion to the NFWF over a five-year period, in connection with resolving a criminal investigation related to the Gulf of Mexico oil spill.[2] Shortly after the BP settlement was announced, then-Senator Mary Landrieu (whose state was arguably the biggest victim on the Gulf of Mexico spill) complained publicly about the DOJ's decision to direct so much recovery money to a single foundation, the board of which "include[d] only one person from the Gulf of Mexico."[3]

- The phenomenon is not new: The U.S. Attorney for Connecticut in 2006 required a wastewater treatment firm accused of violating the Clean Water Act to "donate" $1 million to the Alumni Association for the United States Coast Guard Academy in New London, Connecticut to fund an Endowed Chair of Environmental Studies.[4] The wastewater treatment firm was also forced to pay an additional $1 million to the Greater New Haven Water Pollution Control Authority in New Haven, Connecticut, to fund unspecified "environmental improvement projects."[5]

There is no justification for these "private grant programs," which violate the Constitution, lack any legitimate statutory basis, and threaten the public interest. Congress should prohibit them.

Just as troubling, though occasionally authorized by statute, is the frequent practice of agencies retaining for their own use the proceeds of private parties' payments to the federal government in connection with settlements—in effect, self-generated supplements to the agency's statutory appropriation. Are enforcement actions that include such payments really justified by the public interest, or are they instead grounded in a desire to expand the agency's size, scope, and influence as well as to be an end run around Congress' power over the purse?

Perhaps the most notorious example of this practice is the Justice Department's asset forfeiture program. In 1985, when the DOJ's asset forfeiture fund was first initiated, it took in only approximately $27 million annually. By 2011, that figure had ballooned to $1.8 *billion*.[6]

Discussing the potential problems and perverse incentives created by the DOJ's equitable sharing program and asset forfeiture practices, the American Civil Liberties Union stated: "When salaries and perks are on the line, officers have a strong incentive to increase the seizures, as

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2 *See* Juliet Elperin, "BP Settlement a Boon to Conservation Group," Washington Post (Nov. 16, 2012), available at http://www.washingtonpost.com/national/health-science/bp-settlement-a-boon-to-conservation-group/2012/11/16/ddcb2790-302b-11e2-a30e-5ca76eeec857_story.html.

3 *Id.*

4 News Release, U.S. Attorney's Office (D. Conn.), "OMI and U.S. Enter into Deferred Prosecution Agreement" (Feb. 8, 2006), available at www.usdoj.gov/usao/ct/press2006/20060208.html.

5 *Id.*

6 U.S. GAO, GAO-12-736, JUSTICE ASSETS FORFEITURE FUND: TRANSPARENCY OF BALANCES AND CONTROLS OVER EQUITABLE SHARING SHOULD BE IMPROVED, at 11 (2012) available at http://www.gao.gov/assets/600/592349.pdf.

evidenced by an increase in the regularity and size of such seizures in recent years."[7] Other commentators have also explained that allowing authorities to retain forfeited assets can distort legitimate enforcement priorities by incentivizing the pursuit of more valuable assets rather than more dangerous criminals and encouraging authorities to divert investigative resources away from those cases that are less likely to produce lucrative asset seizures.[8] Indeed, concerns over the DOJ's asset forfeiture program reached such a fever pitch that even Attorney General Eric Holder was forced to admit "a comprehensive review" of the program was needed.[9]

But the asset forfeiture program is not at all unique. The Consumer Financial Protection Bureau,[10] the Environmental Protection Administration,[11] and the Departments of Justice and Health and Human Services[12] each maintain similar "slush fund" accounts in which settlement payments are deposited and then expended by the agencies, without congressional action. The total amounts of money involved ranges in the multiple billions of dollars.

In our view, Congress should reassert its constitutional authority, eliminate these accounts, and require all settlement proceeds to be deposited into the Treasury.

The Subcommittee's attention to these troubling abuses of executive authority is timely and welcome. The Chamber and ILR would be happy to provide any additional information that would be useful to the Subcommittee's inquiry.

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7 ACLU, "Law Reform: Civil Asset Forfeiture" (2015), available at https://www.aclu.org/criminal-law-reform/civil-asset-forfeiture.

8 *See* Eric Blumenson & Eva Nilsen, "Policing for Profit: the Drug War's Hidden Economic Agenda", 65 U. Chi. L. Rev. 35, 66 (1998).

9 *See* DOJ Press Release, "Attorney General Prohibits Federal Agency Adoptions of Assets Seized by State and Local Law Enforcement Agencies Except Where Needed to Protect Public Safety," (Jan. 16, 2015), available at http://www.justice.gov/opa/pr/attorney-general-prohibits-federal-agency-adoptions-assets-seized-state-and-local-law.

10 *See* 12 C.F.R. § 1075.100 (describing the CFBP's administration of the fund); *see also* CFPB Release, "Strategic plan, budget, and performance plan and report" (2015), at 12 & 22, available at http://files.consumerfinance.gov/f/strategic-plan-budget-and-performance-plan-and-report-FY2013-15.pdf.

11 *See* 47 U.S.C. § 1395i(k); *see also* HHS & DOJ, "Health Care Fraud and Abuse Control Program, Annual Report for Fiscal Year 2013" at 8. (Feb. 2014), available at http://oig.hhs.gov/publications/docs/hcfac/FY2013-hcfac.pdf.

12 *See, e.g.*, 42 U.S.C. § 9622 (b)(3).

CAUSE of ACTION
Advocates for Government Accountability

To:	Interested Parties
From:	Cause of Action Staff
Subject:	Investigation of Bank of America Settlement Recipient NeighborWorks America
Date:	February 11, 2015

This document summarizes Cause of Action's ("CoA") investigation of NeighborWorks America ("NeighborWorks"), a congressionally chartered non-profit and beneficiary of the $7 billion consumer relief portion of the August 21, 2014 Settlement Agreement between the Department of Justice ("DOJ") and Bank of America (the "Bank").[1]

- NeighborWorks is one of the Department of Housing and Urban Development ("HUD")-approved Housing Counseling Agencies[2] eligible to receive donations from the Bank, which operate as credits towards the Bank's consumer relief obligation.[3] The Bank has an incentive to make such donations, because a $1.00 payment equals a $2.00 credit.[4] Further, if the Bank does not fulfill its consumer relief obligation by August 31, 2018, the Bank must pay liquidated damages in an amount equal to the shortfall with 25% payable to NeighborWorks.[5]

- In a letter to DOJ dated November 25, 2014, the House Judiciary Committee and House Committee on Financial Services (the "Committees") requested information regarding the use of bank settlements to fund organizations such as NeighborWorks.[6] DOJ's January 6, 2015 reply letter fails to acknowledge that NeighborWorks is an organization eligible for donations from the Bank.[7] **More importantly, DOJ's letter ignores the fact**

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[1] *See* Settlement Agreement between DOJ and the Bank (Aug. 21, 2014), *available at* http://www.justice.gov/iso/opa/resources/3392014829141150385241.pdf ("Settlement Agreement"); *see also* Settlement Agreement, *Annex 2 – Consumer Relief* (Aug. 21, 2014), Menu Items 1 – 4, *available at* http://www.justice.gov/iso/opa/resources/8492014829141239967961.pdf ("Annex 2").

[2] The Settlement Agreement provides a link (http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm) to the list of HUD-approved Housing Counseling Agencies. *See* Annex 2 at fn. 22. The website lists NeighborWorks under "Washington, DC" as "NEIGHBORHOOD REINVESTMENT CORP. DBA NEIGHBORWORKS AMERICA."

[3] *See* Annex 2, Menu Item 3.G (specifying a $20 million donation minimum, but no maximum).

[4] *See id.* The Bank also receives a 115% early incentive credit for donations completed by August 31, 2015. *See id.*

[5] *See id.*, *Credit Minimums, Reporting Requirements, and Liquidated Damages*, p. 10.

[6] Letter from Hon. Bob Goodlatte, Chairman, H. Comm. on the Judiciary, and Hon. Jeb Hensarling, Chairman, H. Comm. on Financial Services, to Hon. Eric Holder, then-Attorney General, Dep't. of Justice (Nov. 24, 2014), http://judiciary.house.gov/_cache/files/62465e3d-0486-4f4b-bc2e-d5fe491138eb/11-25-14-joint-bg-jh-to-doj-on-mortgage-settlements.pdf.

[7] Letter from Peter Kadzik, Asst. Attorney General, Dep't of Justice, to Hon. Bob Goodlatte, Chairman, H. Comm. on the Judiciary, and Hon. Jeb Hensarling, Chairman, H. Comm. on Financial Services (Jan. 6, 2015) (on file with

that the Settlement Agreement does not impose a donation cap.[8] Conceivably, the Bank could donate $2 billion to NeighborWorks and receive $4 billion in settlement credit.

- CoA previously investigated the connection between NeighborWorks, the now-defunct Association of Community Organizations for Reform Now ("ACORN"), and affiliates of ACORN. CoA's website (http://causeofaction.org/our-work/acorn/) summarizes the relationship among these entities and resulting concerns. Of particular note:

    - In 2009, Congress banned funding to ACORN and any ACORN affiliates, subsidiaries or allied organizations. ACORN Housing Corporation ("AHC") is an affiliate of Affordable Housing Centers of America ("AHCOA"). Records show that ACORN simply changed its name to AHCOA.[9]

    - In a September 29, 2010 advisory opinion, the Government Accountability Office ("GAO") determined that AHCOA "is not an affiliate", "subsidiary", or "allied organization" of ACORN, thus allowing AHCOA (*i.e.*, ACORN) to continue receiving federal funds.[10] Significantly, GAO determined that NeighborWorks's appropriations from HUD are available for grants to AHCOA.[11] AHCOA continued to receive taxpayer funding via grants from NeighborWorks (from HUD appropriations) until June 7, 2011[12] and via direct HUD grants through at least September 2, 2011.[13] Other rebranded ACORN organizations also continued to receive taxpayer funding and, in August 2012, CoA published a list of 174 still-active ACORN organizations connected to old ACORN groups by means of having the same physical location, shared leadership or staff, and/or the same tax ID number.[14]

    - **In terms of discretionary funding, CoA's investigation revealed that HUD's funding of AHCOA reflects poor grant oversight.**

    - By letter dated September 21, 2009, Senator Dodd, then Chairman of the Senate Committee on Banking, Housing and Urban Affairs, requested the Internal Audit Director of NeighborWorks to investigate AHC's use of certain federal funds.

CoA). The letter only discusses NeighborWorks' eligibility for funds related to the Settlement Agreement's liquidated damages provision.

[8] *See* Annex 2, Menu Item 3.G.

[9] *See ACORN Gets Another $350,000 in American Taxpayers' Money*, CAUSE OF ACTION (Dec. 6, 2011), http://causeofaction.org/acorn-gets-another-350000-in-american-taxpayers-money/.

[10] *See* letter from Lynn H. Gibson, Acting General Counsel, GAO, to Jeffrey T. Bryson, General Counsel, NeighborWorks (Sept. 29, 2010), B-320329, *available at* http://www.gao.gov/decisions/appro/320329.htm.

[11] *See id.*

[12] NeighborWorks America, Round 5NFMC Funding (June 7, 2011), *available at* http://www.neighborworks.org/DocumentsOLD/HomeandFinance_Docs/Foreclosure_Docs/ForeclosureCounseling%28NFMC%29_Docs/AR5awardsbyawardamount.aspx (listing grant recipients by award amount).

[13] *See ACORN*, CAUSE OF ACTION, http://causeofaction.org/our-work/acorn/.

[14] *See List of Still-Active ACORN Entities, ACORN Allies, and Rebranded ACORN Organizations*, CAUSE OF ACTION (Aug. 22, 2012), http://causeofaction.org/still-active-acorn-entities-acorn-allies-and-rebranded-acorn-organizations/.

NeighborWorks issued a report to Senator Dodd dated December 17, 2010.[15] The report documents AHCOA's ties to ACORN as an "affiliate", revealed a substantial financial relationship between AHCOA and ACORN, and found a number of violations by ACHOA.[16]

- **However, CoA's investigation concluded that NeighborWorks may have intentionally delayed release of its audit until after GAO released its report, so that the affiliation between ACORN and AHCOA would not appear in the GAO report. Whether Members of Congress or agency employees knew about (or even encouraged) an intentional delay to allow ACORN, via AHCOA, to continue to receive funding remains unclear.**[17]

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[15] *See* NeighborWorks America, Office of Internal Audit, *Special Audit of the Use of National Foreclosure Mitigation Counseling Program Grant Funds by ACORN Housing Corporation, Inc.* (Dec. 17, 2010), *available at* http://www.neighborworks.org/DocumentsOLD/AboutUs_Docs/PublicPolicy_Docs/FOIA_Docs/Reading-Room/SpecialAuditRedactionsApplied-10-18-11_Redacted.aspx. Although NeighborWorks publicly posts its internal audits, it did not initially make this report available online. As a result of CoA's investigative efforts, NeighborWorks placed this redacted copy of its report on its website.

[16] *See id.*; *see also Federal Audit: ACORN Received Your Money*, CAUSE OF ACTION (Dec. 6, 2011), http://causeofaction.org/federal-audit-acorn-received-your-money/.

[17] *See Federal Audit: ACORN Received Your Money*, CAUSE OF ACTION (Dec. 6, 2011), http://causeofaction.org/federal-audit-acorn-received-your-money/ (". . . [CoA] was able to determine that Congress asked NeighborWorks to post its internal audits several months ago, but the recommendation was at first denied by NeighborWorks' Board of Directors. One of these Board members is an Assistant Secretary at HUD. Given the fact that HUD's General Counsel determined AHCOA was not an ACORN affiliate, it should be no surprise that HUD would attempt to prevent the release of an audit that refuted its conclusions concerning the relationship between AHCOA and ACORN.").

Mr. MARINO. We have a very distinguished member today from the Department of Justice. Welcome, sir, and I will begin by swearing you in. Would you please stand and raise your right hand, please?

Do you swear that the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Mr. GRABER. I do.

Mr. MARINO. Thank you. Let the record reflect that the witness has responded in the affirmative, and please take a seat.

Mr. Geoffrey Graber is a deputy assistant attorney general and the director of Residential Mortgage-Backed Securities Working Group of the Financial Fraud Enforcement Task Force for the United States Department of Justice. Mr. Graber was an associate for the San Francisco branch of Morrison & Foerster prior to joining the Justice Department's Civil Division. At the litigation department of Morrison & Foerster, Mr. Graber specialized in consumer class actions, securities fraud, product defects, tort, contract law, and general civil litigation.

Mr. Graber is a graduate of the University of Southern California Law School. And I also understand that you do a pretty good Alec Baldwin/Glenn Close imitation?

Mr. GRABER. Yes.

Mr. MARINO. We may need that some time through the testimony here, sir. The witness' written statement will be entered into the record in its entirety, and I ask if you would please summarize your opening testimony in 5 minutes or less. And to help you stay within the guidelines, there is a timing light in front of you, and when the light switches from green to yellow, it indicates that you have 1 minute to conclude your testimony. When the light turns to red, it indicates that your 5 minutes have expired. And I will just politely, because sometimes it is difficult to keep an eye on the lights and talk. So I will just politely tap here to give you an indication that your time has run out, and please sum up at that point.

I now recognize Mr. Graber to give his opening statement.

TESTIMONY OF GEOFFREY GRABER, DEPUTY ASSOCIATE ATTORNEY GENERAL AND DIRECTOR, RMBS WORKING GROUP OF THE FINANCIAL FRAUD ENFORCEMENT TASK FORCE, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. GRABER. Thank you. Chairman Marino, Chairman Goodlatte, and Ranking Member Conyers, and Members of the Subcommittee, thank you for inviting me here and for providing the Department of Justice the opportunity to appear at today's hearing to describe a series of settlements that have arisen out of the Department's efforts to address fraud in connection with the packaging and sale of residential mortgage-backed securities.

In November 2009, the Financial Fraud Enforcement Task Force was established in order to strengthen the efforts of the Department of Justice to pursue potential misconduct committed in connection with the financial crisis. And in January 2012, the Department of Justice formed the Residential Mortgage-Backed, or RMBS, Working Group, in the task force to investigate those responsible for misconduct contributing to the financial crisis through the pooling and sale of residential mortgage-backed securities.

The efforts of the RMBS Working Group have focused on achieving accountability from financial institutions that engaged in wrongdoing relating to residential mortgage-backed securities and, to the extent possible, bringing some measure of relief to homeowners who suffered as a result of the financial crisis. These goals reflect the fact that misconduct in the RMBS market impacted the entire financial system and the American economy as a whole.

To date, the efforts of the RMBS Working Group have secured resolutions valued at more than $36.6 billion in penalties, compensation, and consumer relief to investors, victims, and the American people. These settlements each embody the goals spelled out in the formation of the RMBS Working Group.

First, each settlement achieved accountability by requiring a significant and, in some cases, record monetary penalty, as well as a statement of facts acknowledging the evidence underlying the government's allegations. These penalties will hopefully serve to deter future misconduct, and the statements of fact serve as an acknowledgment by the banks to their shareholders and the American public of the misconduct uncovered by the Department of Justice.

Second, each bank committed to provide many billions of dollars of consumer relief of a type that is designed to enable many Americans to stay in their homes. These consumer relief provisions provide an especially salient feature to these settlements. This type of relief likely could not have been ordered by a court even if the government has prevailed at trial. In general, the consumer relief component consists of a menu of different types of consumer relief, menus developed in consultation with the Department's law enforcement partners, including Federal regulatory agencies and states.

In each of these resolutions, the settling bank can fulfill its obligations to implement consumer relief by undertaking the consumer relief set forth on the menu. The banks agreed to meet certain consumer relief targets. The agreements establish certain constraints on how the relief is to be provided. Beyond that, though, the banks have latitude to decide precisely how to satisfy their consumer relief obligations.

For example, the Bank of America settlement provided for a total of $7 billion in consumer relief, including a minimum of $2.15 billion in first lien forgiveness calibrated to help homeowners who face the risk of default and foreclosure. Within this broad target, though, the bank has discretion to decide precisely how to provide such relief.

As a second example, the various settlements all contemplate neighborhood reinvestment activities, a type of relief that includes the provision of certain kinds of foreclosure prevention assistance and other counseling activities. This is to be provided by certain categories of organizations chosen by the bank that will receive a directed donation to perform the types of activities specified in the agreements, such as foreclosure prevention and counseling activities.

These include organizations that help veterans avoid foreclosure, organizations that deal with abandoned properties that can inhibit neighborhood recoveries or organizations to help prospective home purchases navigate the process of buying a home. With the single

exception of IOLTAs, the banks choose which specific organizations receive these donations. The Department of Justice does not mandate that any money will go to any specific third party charity organization.

The RMBS Working Group has achieved a great deal in fighting financial fraud. These efforts have resulted in record civil penalties, factual statements in civil cases that show an unprecedented level of accountability from the financial institutions and transparency to the marketplace, and meaningful consumer relief for the American people.

Thank you once again for the opportunity to appear before you today. At this time, Mr. Chairman, I would be happy to address any questions you or Members of the Subcommittee may have.

[The prepared statement of Mr. Graber follows:]

Department of Justice

TESTIMONY OF

GEOFFREY GRABER
DEPUTY ASSOCIATE ATTORNEY GENERAL AND
DIRECTOR OF THE RESIDENTIAL MORTGAGE-BACKED
SECURITIES WORKING GROUP OF
THE FINANCIAL FRAUD ENFORCEMENT TASK FORCE
U.S. DEPARTMENT OF JUSTICE

BEFORE THE

SUBCOMMITTEE ON REGULATORY REFORM, COMMERCIAL AND ANTITRUST LAW
COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES

FOR A HEARING CONCERNING

OVERSIGHT OF THE JUSTICE DEPARTMENT'S MORTGAGE LENDING SETTLEMENTS

PRESENTED ON

FEBRUARY 12, 2015

Testimony of Geoffrey Graber
Deputy Associate Attorney General and
Director of the Residential Mortgage-Backed Securities Working Group of
The Financial Fraud Enforcement Task Force
Before the Subcommittee on Regulatory Reform, Commercial and Antitrust Law
Committee on the Judiciary
U.S. House of Representatives
February 12, 2015

Chairman Marino, Vice Chairman Farenthold, and Members of the Subcommittee, thank you for inviting me here and for providing the Department of Justice the opportunity to appear at today's hearing to describe a series of settlements that have arisen out of the Department's efforts to address fraud in connection with the packaging and sale of Residential Mortgage-Backed Securities.

In late 2008, the financial system and the broader American economy underwent tremendous shock. There were many contributing factors to the financial crisis. High among them, though, was the interconnectedness between troubles in the housing market and the packaging and trading of a particular type of security known as "Residential Mortgage-Backed Securities," or "RMBS."

In the lead-up to the financial crisis, investments in RMBS yielded tremendous losses, of a magnitude that quickly infected the broader economy. This led to a classic vicious cycle: it has been widely noted that weaknesses in the housing market undermined the value of RMBS, and losses caused by RMBS contributed to the cratering of the housing market.

In November 2009, the Financial Fraud Enforcement Task Force was established in order to strengthen the efforts of the Department of Justice to pursue potential misconduct committed in connection with the financial crisis. And, in January 2012, the Department of Justice formed the Residential Mortgage-Backed Securities (RMBS) Working Group in the Task Force to investigate those responsible for misconduct contributing to the financial crisis through the pooling and sale of residential mortgage-backed securities.

The RMBS Working Group – which comprises several federal agencies, U.S. Attorneys, and state attorneys general – seeks to "hold accountable those who broke the law, speed assistance to homeowners, and help turn the page on an era of recklessness that hurt so many Americans."[1]

So this effort has focused on: achieving accountability from financial institutions that engaged in wrongdoing relating to residential mortgage-backed securities, and, to the extent possible, bringing some measure of relief to homeowners who suffered as a result of the financial crisis. These goals reflect the fact that misconduct in the RMBS market impacted the entire financial system and the American economy as a whole. For example, at least one federal district

[1] Remarks by the President in State of the Union Address, United States Capitol, January 24, 2012. *Available at:* http://www.whitehouse.gov/the-press-office/2012/01/24/remarks-president-state-union-address.

court has concluded "the court need not . . . be an expert in economics to take notice that it was the trading of toxic RMBS between financial institutions that nearly brought down the banking system in 2008."

Cases arising out of the packaging and sale of RMBS are difficult to develop, involving highly complex transactions undertaken by some of the world's most sophisticated financial actors. But, as a result of the efforts of our dedicated teams of attorneys, investigators and staff, the Department and its federal and state law enforcement partners have taken significant steps to address RMBS related misconduct.

To date, the efforts of the RMBS Working Group have secured resolutions valued at more than $36.6 billion in penalties, compensation and consumer relief to investors, victims, and the American people. The Department has filed one lawsuit against Bank of America in connection with its RMBS activities, and has entered three settlements:

- In November 2013, the Department (along with state and federal partners) entered a $13 billion resolution with J.P. Morgan Chase, which was, at the time, the largest settlement with a single entity in Department history.

- Thereafter, in July 2014, Working Group members entered a $7 billion resolution with Citibank, which included a $4 billion civil monetary penalty (a record at the time).

- Then, on August 21, 2014, the Department announced a $16.65 billion resolution with Bank of America. This settlement constitutes the largest resolution with a single defendant in the Justice Department's history, and included a record-breaking penalty of $5 billion.

These settlements each embody the goals spelled out in the formation of the RMBS Working Group.

First, each settlement achieved accountability by requiring a significant (and in some cases record) monetary penalty, as well as a statement of facts acknowledging the evidence underlying the government's allegations. These penalties will hopefully serve to deter future misconduct; and the statements of facts serve as an acknowledgement by the banks to their shareholders and the American public of the misconduct uncovered by the Department of Justice.

Second, each bank committed to provide many billions of dollars of consumer relief, of a type that is designed to enable many Americans to stay in their homes, and will enable many more to secure homeownership for the first time (the particular settling banks had origination and/or servicing operations that helped facilitate this type of relief).

These consumer relief provisions – in which the settling banks agreed to provide billions of dollars in relief for consumers in the housing market – provide an especially salient feature of these settlements. This type of relief likely could not have been ordered by a court, even if the government had prevailed at trial.

In general, the consumer relief component consists of a menu of different types of consumer relief – menus developed in consultation with the Department's law enforcement partners, including federal regulatory agencies and states.

In each of these resolutions, the settling bank can fulfill its obligations to implement consumer relief by undertaking the consumer relief set forth on the menu. The banks agreed to meet certain consumer relief targets. For example, J.P. Morgan Chase agreed to secure $4 billion in consumer relief credits. The agreements establish certain constraints on how the relief is to be provided (such as minimum or maximum commitments for certain types of relief). Beyond that, though, the banks have latitude to decide precisely how to satisfy their consumer relief obligations.

For example, the Bank of America settlement provides for a total of $7 billion in consumer relief, including a minimum of $2.15 billion in 1st lien forgiveness calibrated to help homeowners who face the risk of default and foreclosure: Reducing the unpaid principal allowance results in more manageable mortgage payments, greater equity in the home, and a reduced risk of default or foreclosure. Within this broad target, though, the bank has discretion to decide precisely how to provide such relief (*i.e.*, which mortgages should be selected for principal reduction) and whether it will go beyond its $2.15 billion minimum first lien obligation in the course of meeting its total $7 billion obligation.

As a second example, the various settlements all contemplate neighborhood reinvestment activities – a type of relief that includes the provision of certain kinds of foreclosure prevention assistance and other counseling activities. This is to be provided by certain categories of organizations, chosen by the bank, that will receive a directed donation to perform the types of activities specified in the agreements (such as foreclosure prevention assistance and other housing counseling activities). These include organizations that help veterans avoid foreclosure, organizations that deal with abandoned properties that can inhibit neighborhood recoveries, or organizations that help prospective home purchasers navigate the process of buying a home. With a single exception (donations to state-based Interest on Lawyer Trust Accounts organizations, which then distribute those funds to organizations of the IOLTA's choosing for use in foreclosure prevention legal assistance and community redevelopment legal assistance), the banks choose which specific organizations receive these donations.

The settlement agreements also provide for varying levels of "credits" for certain types of consumer relief. With respect to some types of consumer relief, such as 2nd lien forgiveness, the banks generally receive less than one dollar of credit for each dollar of consumer relief provided. For other types of consumer relief, however, the banks can receive more than one dollar of credit for each dollar of consumer relief provided. This mechanism reflects a variety of factors, including the fact that certain types of consumer relief are more expensive for the banks to accomplish.

It is important to bear in mind, however, that the Department does not have control over how the banks choose to complete their consumer relief obligations within the parameters set forth in the settlement agreements. It is up to the banks to choose exactly how they fulfill their obligations.

In all of these settlements, the banks are required to report their consumer relief efforts to independent monitors, who are paid by the banks. The independent monitors are charged with verifying that the banks meet their consumer relief obligations. The monitors also publicly report their findings.

The RMBS Working Group has achieved a great deal in fighting financial fraud. These efforts have resulted in record civil penalties; factual statements in civil cases that show an unprecedented level of accountability from the financial institutions and transparency to the marketplace; and meaningful consumer relief for the American people.

We will continue to pursue RMBS cases, following the facts wherever they lead, and enforcing the law fairly but aggressively where we uncover evidence of unlawful conduct.

Thank you, once again, for the opportunity to appear before you today. At this time, Mr. Chairman, I would be happy to address any questions you or Members of the Subcommittee may have.

Mr. MARINO. Thank you, Mr. Graber. And because the Chairman of the full Committee has to be in three places at once, I am going to defer to him for his questioning for 5 minutes. So, Chairman Goodlatte.

Mr. GOODLATTE. Mr. Chairman, thank you for your consideration. Mr. Graber, welcome. You are a litigator, so you know failure to provide discovery can trigger an order to a jury to draw an adverse inference. And that is what we are doing right now because I along with Chairman Hensarling of the Financial Services Committee requested all communications pertaining to the mandatory donations provisions in the bank settlements over 2 months ago, but we have yet to receive any responsive documents from the Department of Justice. When can we expect to receive that?

Mr. GRABER. Thank you, Mr. Chairman. I appreciate the concern, and I understand the concern. I can tell you that we are in process of reviewing documents that may be responsive to the Committee's request.

Mr. GOODLATTE. Will the Department of Justice claim any privileges over a significant percentage of the relevant documents?

Mr. GRABER. Well, because the review is ongoing, sitting here today, I cannot tell you whether or not there would be any type of assertion of privilege. But I can assure you that a review is ongoing, and——

Mr. GOODLATTE. Well, let me just add that this Committee will not stand silent, nor will, I am sure, the Financial Service Committee, and you can expect that this will escalate if you do not provide the documentation that we requested over 2 months ago.

Secondly, did anyone at the Department of Justice ever consider the serious appearance of impropriety in requiring banks to make available to activist organizations the lion's share of funding that Congress has previously cut off to them? That is one of the reasons why we want to see the communications. We want to know what considerations went into making this decision to take this action.

Mr. GRABER. Thank you, Mr. Chairman. Again, I understand the concern. And I can tell you that one of the reasons that the Department wanted to use a preexisting list, the one that I believe you are referring to, the HUD approved counseling agency list, is because that list is preexisting. The Department did not want to be in the business of picking and choosing which organization may or may not receive any funding under the agreement.

Mr. GOODLATTE. No, but it is the Congress' responsibility to appropriate funds, and the Congress' responsibility to be picking and choosing who gets appropriations for expenditures. And we want to know what connection there is between the fact that cuts were made and then apparently restored through a settlement.

Mr. GRABER. Well, Mr. Chairman, to my knowledge there was never any discussion of a decision by Congress to cut funding one way or another to various third party organizations and the negotiations that took place in the lead up to these settlements.

Mr. GOODLATTE. You do understand that the Constitution very specifically provides in Article 1 that no money shall be drawn from the Treasury but in consequence of appropriations made by law. And when you make a settlement and you require funds to be paid as part of a fine, a settlement, those funds are deposited into the

Treasury. And if you make a decision to divert some of those funds before they ever get into the Treasury, we have very serious questions about whether you are attempting, through the Department of Justice, to fulfill the function of the Congress to appropriate funds.

So please explain to us why you think the framers thought this was so important and your personal view of its role in the separation of powers.

Mr. GRABER. Mr. Chairman, the way these settlements were structured was that certain funds, namely the civil penalties, were deposited directly into the Treasury. These were the record civil FIRREA penalties that were obtained——

Mr. GOODLATTE. Well, we understand that.

Mr. GRABER. Right. The——

Mr. GOODLATTE. But other funds, which could have been a part of that settlement, said it is one lump sum and it goes into the Treasury. Instead it said pay us this money, and we order you to pay other money to other people.

Mr. GRABER. Right. So the other components to the settlement, in particular the monies that you are referring to that would go to the HUD approved counseling agencies, those funds were never diverted. They were a separate part of the settlements. There was the civil penalty component of the settlements. There are other components of the settlements, and then there is this small portion relating to the counseling agencies.

Mr. GOODLATTE. "Small" is a relative term when you are talking about $150 million, right?

Mr. GRABER. I am sorry?

Mr. GOODLATTE. I said "small" is a relative term when you are talking $150 million.

Mr. GRABER. Well, the $150 million is——

Mr. GOODLATTE. It is a lot of money to most people. I do not know how many thousands of additional people that were ostensibly being protected by this whole prosecution that would have been receiving additional direct help if the funding had gone into the Treasury as opposed to elsewhere.

But first and foremost, once it went into the Treasury, then the elected representatives of the people would get to decide the most appropriate way to use those funds. It might be to reduce the $18 trillion debt of our country. It would make a small dent in that. There are lots of different things that could be done with that money if it had not been, I would argue, appropriated by the Department of Justice to go to places where the Congress had already made decisions that funding did not need to go in its larger fund.

But the bottom line is get us the documents. If you want to assert what your position as to how this came down, get us the documents that show us what communications were made and how that was done, and get them to us expeditiously. Thank you, Mr. Chairman.

Mr. GRABER. Thank you.

Mr. MARINO. Thank you. The Chair now recognizes the Ranking Member of the full Committee, the gentleman from Michigan, Congressman Conyers.

Mr. CONYERS. Thank you, Mr. Chairman, and welcome, Mr. Graber. Would you please describe the fraudulent conduct of JPMorgan, Citigroup, Bank of America, that gave rise to settlement agreements? How does this conduct directly relate to the mortgage foreclosure crisis?

Mr. GRABER. Thank you, Congressman. The Department conducted extensive investigations in the lead-up to each of these settlements. And as outlined more fully in the statement of facts that accompanied each of the settlements, the Department's investigations revealed, generally speaking, that with respect to each of the financial institutions, these financial institutions made a variety of representations to RMBS investors, in particular that the securities that were collateralizing the—excuse me—the mortgages that were collateralizing the securities were underwritten generally in accordance with underwriting guidelines, that folks could repay the mortgages that were being taken out, that the income was verified or the income was accurately stated on the loan applications. They made a variety of representations like that.

The Department's investigations revealed that the banks received information at the time of the securitization that was inconsistent with those representations. That information put them on notice that the representations were false, and investors were never told of that information either. So, as I said, those allegations are—those facts, I should say, are laid out in more detail in the statements of facts. But that is in general what the Department's investigations revealed.

Mr. CONYERS. Thank you. Now, do you recall what the total minimum requirement for donations to HUD-approved housing counseling agencies under the Bank of America and Citigroup settlements were?

Mr. GRABER. Yes. I believe that in the Citigroup settlement, the minimum to which you are referring is approximately $10 million, and in the Bank of America settlement it is $20 million. And in each of those cases—I believe I have the math right—it works out to less than 1/10th of 1 percent of the total settlements.

Mr. CONYERS. Okay, thanks. Now, have any of the settling banks donated any funds to third party groups under the terms of the agreements?

Mr. GRABER. Based on the monitor reports that have come out to date, it is my understanding that no money has been directed to third party organizations under the terms of these settlements.

Mr. CONYERS. Now, how rigorous is the approval process for HUD-approved housing counseling agencies? Discuss with us whether there are auditing requirements for these agencies and whether they may be terminated for failing to meet these standards.

Mr. GRABER. So the list of HUD-approved counseling agencies is a list that has been developed and is maintained by HUD. It is not the Department's list, and it is my understanding that it is a congressionally mandated list. It has existed in one form or another since, I believe, 1968. And my understanding is that there is oversight, and there is an auditing process that the Department of Housing and Urban Development maintains. And I also understand

that if there is a failure to comply with the requirements, with HUD's requirements, that they can be removed from the list.

Mr. CONYERS. Thank you. What benefits do HUD-approved housing counselors and State-based legal aid organizations provide to assist consumers?

Mr. GRABER. My understanding is that they provide very valuable assistance to homeowners. You know, it is my understanding that these HUD-approved counseling agencies provide foreclosure assistance. They provide assistance to homeowners to repay their loans and to navigate the loan modification process.

You know, folks around the country have, you know, suffered a lot dealing with, you know, independent third parties who have perpetrated loan modification scams and that type of thing. With these HUD-approved counseling agencies, because they go through such a rigorous process and they are subject to oversight, there is much less of a chance of something like that happening.

Mr. CONYERS. Mr. Chairman, I have three additional questions I would ask him to respond to very briefly, please.

Mr. MARINO. Without objection.

Mr. CONYERS. Thank you, sir. Does the Justice Department have any control or discretion regarding the distribution of funds to third party organizations?

Mr. GRABER. No, we do not. As I stated previously, the banks are required to choose which organization off the list of HUD-approved counseling agencies they will direct funds to. That list, as far as I know, consists of hundreds and hundreds of organizations. Some of them are Catholic Charities affiliated with dioceses around the country, Christian legal service organizations, Jewish charities, and many, many other non-profit organizations. It is up to the bank to decide which organization to which they will direct funds.

Mr. CONYERS. Let me quickly ask these two questions. Do any third party organizations have any influence or discretion regarding the use of funds donated through the settlement agreements?

Mr. GRABER. My understanding is that they are required to use the funds as outlined in the settlement agreement. So the extent any third party organization receives funds through these settlements, they will be required to use them for foreclosure assistance or other forms of housing assistance. And it will be the job of the monitor to ensure that those terms are complied with.

Mr. CONYERS. Thank you. And finally, please discuss the role of independent monitors in verifying that banks meet their consumer relief obligations.

Mr. GRABER. So each one of these settlements includes a monitor. In JPMorgan, the monitor is Joe Smith, and in Citigroup it is Tom Perrelli, and in the Bank of America settlement it is Eric Green. And it is the job of the monitor to ensure that all terms of the settlement are complied with. And more specifically, as the banks fulfill their obligations under the consumer relief component of the settlements, they will report their progress to the monitors. And then it is the job of the monitors to actually, you know, audit and then give credit under the settlement agreement to each of the banks.

So if a bank were to, you know, provide funding or take steps that were inconsistent with the agreement, the monitor would then have the power to not credit those dollars that go out the door.

Mr. CONYERS. Thank you, Mr. Chairman, for your generosity with time.

Mr. MARINO. Thank you. Now, I am going to ask some questions, Mr. Graber. First of all, if you could, I want to understand the genesis of what is going on with this program, and I want to understand the precise mandatory donation provisions in Citibank and American settlements. And could you tell me, first of all, who told you or who was the highest Ranking Member at DOJ involved in making mandatory donation settlements?

Mr. GRABER. Thank you, Mr. Chairman. Each of these settlements was the result of a very long, complex, and arduous negotiation. And there were dozens and dozens of officials from the Department of Justice——

Mr. MARINO. But there had to be an individual from Department of Justice that said this is the route we are going. Who was that?

Mr. GRABER. So if I may, with respect to each of these settlements, when you are talking about the specific terms that were contained in these settlements, I do not think it is fair to say that any single individual was responsible for deciding, you know, whether to go one way or another.

Mr. MARINO. Sir, I disagree with you. I worked at Justice, okay? I was a U.S. attorney. Someone always gave a subordinate direction on what to do. It was either done through face-to-face communication, email, or direct letter. Now, someone had to come up and say who gave the order to do this. Now, do you know what that is?

Mr. GRABER. I am not aware of any direct order.

Mr. MARINO. Would you not ask how your authority was granted? Did you not ask under what circumstances am I permitted to pursue this?

Mr. GRABER. So with respect to the consumer relief component of these settlements, there was a team of, I would say, a dozen or more——

Mr. MARINO. Did the DAG know about this?

Mr. GRABER. These settlements were approved at the highest levels of the Department.

Mr. MARINO. The Attorney General?

Mr. GRABER. The Attorney General is familiar with these settlements, and he——

Mr. MARINO. Okay. Was anyone at the White House involved in these discussions?

Mr. GRABER. I am not aware of anyone at the White House being involved in these negotiations in the lead-up to these settlements.

Mr. MARINO. I am assuming that you are personally not aware. Have you heard of anyone at the White House being involved in these?

Mr. GRABER. I am personally not aware of anyone at the White House being involved. I never heard of anyone at the White House being involved. And I would be very surprised to learn if anyone at the White House was involved or, you know, had any communications with people at the Department of Justice about these set-

tlements because that would be contrary to the protocols of the Department of Justice.

Mr. MARINO. Were there any outside groups that participated in these discussions for mandatory donations?

Mr. GRABER. There was no outside third party group. There was no non-profit or, you know, charitable organization that participated in any way in these negotiations.

Mr. MARINO. Are you familiar with the EPA guidelines, and settlements with third party payments are common with EPA. Are you familiar with those guidelines that EPA has?

Mr. GRABER. I am sorry. Could you repeat that?

Mr. MARINO. Yes. Settlements with third party payment terms are most common in an environmental context. Are you aware of those guidelines?

Mr. GRABER. I have heard of them. I am not particularly familiar with them.

Mr. MARINO. Okay. What guidelines, if you can sum it up for me in 15 seconds, do you follow under this program?

Mr. GRABER. These settlements, and the Department has very clear authority to compromise claims on behalf of the United States, and that is what occurred here. The Department sought the appropriate internal guidance in the lead-up to these settlements.

Mr. MARINO. But you know of no guidelines. Let me give you an example. You know, the mitigation percentage according to environmental procedures should not exceed 80 percent of the SEP costs with two exceptions. For small businesses, maybe set as high as 100 percent, and for SEP costs, maybe set as high as 100 percent. Are you familiar with any of these guidelines that should be followed?

Mr. GRABER. Well, those are guidelines that I believe apply to environmental settlements. These are not environmental settlements.

Mr. MARINO. I understand. I understand that clearly, but they are guidelines. As the Chairman said, we are talking about millions of dollars to be handed out. And there are indications that the Justice Department is just picking and choosing. Now, the issue is not if it is a left-leaning group. It may be. The issue is someone at Justice, someone, as you said, at the highest levels is picking and choosing who should get this money. And it is usually to organizations that may consult with people after they have lost their house, but it has nothing to do with those that are in mortgage foreclosure on how to help those individuals. So could you please, what say you about that?

Mr. GRABER. Thank you, Mr. Chairman. I understand the concern. The Department did not want to be in the position of picking and choosing who may or may not receive funds with respect to this component of the consumer relief provisions in these settlements. And that is why we, you know, decided that it would be best to use a preexisting list that contains hundreds and hundreds of organizations.

Mr. MARINO. I understand the list. The list is not the issue. The issue is someone makes the decision to whom that goes. Someone has communication from the Justice Department, at least I believe, with the banks as to here is a list of names, or here are a couple of names on who the donations can be made to.

But let me read you something, a letter dated May 14th of 2008 from Mark Filip, Deputy Attorney General. "Plea agreements, deferred prosecution agreements, non-prosecution agreements, and extraordinary restitution." There is a lot here. I want to do this on the record if there is no objection. But here is the line that is important. "Apart from the limited circumstances described below, this practice is restricted because it can create actual or perceived conflicts of interest and/or other ethical issues."

And this is why we are holding this hearing today. As the Chairman said, perhaps if we would have received the documents that we requested a long time ago, maybe you would not be here today. But it has been customary from the Justice Department to drag things out for not only 6 months, but over a year. So the taxpayers have a right to know where hundreds of millions of dollars are going, and if someone is cherry picking left wing organizations or right wing organizations to hand out this money.

I see my time has expired, so now I am going to ask the gentleman from New York, Mr. Jeffries?

Mr. JEFFRIES. Thank you, Mr. Chairman. Let me also thank the distinguished Ranking Member of the entire Committee. Mr. Graber, in 2008 our economy collapsed, correct?

Mr. GRABER. Yes. Well, there was certainly a very severe financial crisis that began around 2008.

Mr. JEFFRIES. Right. In fact, it was the worst economic crisis that this country has experienced since the Great Depression, correct?

Mr. GRABER. I would agree with that.

Mr. JEFFRIES. And millions of Americans lost their homes as a result of this financial collapse. Is that correct?

Mr. GRABER. That is correct.

Mr. JEFFRIES. Okay. And this collapse was in large measure triggered by the reckless behavior of some financial institutions engaged in the mortgage-backed securities market, correct?

Mr. GRABER. I would agree that that was a contributing factor.

Mr. JEFFRIES. Right. I think economists who are in any way objective about what happened have indicated that that was a large part of the economic trauma that this country experienced, in fact is an extraordinary experience. We are discussing an ordinary remedy to deal with what was an extraordinary experience. And so, I am not quite clear what the controversy is.

But in response to this economic collapse, the Department of Justice initiated these lawsuits against financial institutes who were in part responsible for this economic trauma, correct?

Mr. GRABER. I think that is correct. I mean, in light of what occurred, you know, and what occurred in the RMBS market and in the broader economy in general, that was certainly a significant contributing factor to the Department's decision to allocate resources to pursue these investigations, yes.

Mr. JEFFRIES. Now, we are discussing settlements against three major financial institutions where an extraordinary amount of money was secured as a result of the behavior that was conducted, true?

Mr. GRABER. I would agree with that.

Mr. JEFFRIES. And can you give me that number again?

Mr. GRABER. The Department has secured over $36.6 billion through the three settlements that are being discussed today.

Mr. JEFFRIES. And is it fair to say that the overwhelming majority of this money secured by the Department of Justice independent of any congressional action—I am not aware of Members of Congress participating in the litigation—that the overwhelming majority of this funding went to direct consumer relief for everyday Americans who were harmed by the behavior of these financial institutions triggering the economic collapse, correct? The overwhelming majority went to everyday Americans. Is that true?

Mr. GRABER. I would say, yes, that the vast majority of the monies that have been recovered through these settlements have either gone to civil FIRREA penalties and to consumer relief, and the vast majority of that consumer relief—I would say actually all of it—is going to provide some measure of relief to homeowners who have suffered as a result of the financial crisis.

Mr. JEFFRIES. Okay. Let me enter into the record, with the distinguished Chairman's approval and unanimous consent, if that be issued, a statement by the Center for American Progress dated February 12, 2015.

Mr. MARINO. Without objection.

[The information referred to follows:]

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Statement of Julia Gordon
Center for American Progress

Before the House Committee on the Judiciary
Subcommittee on Regulatory Reform, Commercial and Antitrust Law
"Consumers Shortchanged? Oversight of the
Justice Department's Mortgage Lending Settlements"

February 12, 2015

Chairman Marino, Ranking Member Johnson, and members of the committee, my name is Julia Gordon, and I direct the housing and consumer finance team at the Center for American Progress, a nonpartisan think tank dedicated to improving the lives of Americans through progressive ideas and action. I greatly appreciate the opportunity to submit written testimony today concerning consumer relief under the mortgage settlements negotiated by the Department of Justice and other federal agencies.

The first major mortgage settlement took place in 2012 when the Department of Justice and 49 state attorneys general settled with five banks and mortgage servicers for 25 billion dollars.[1] This settlement provided credit to banks for a variety of actions aimed at helping consumers, including loan modifications with principal reduction, loan forgiveness on second liens, and short sales.

However, the shortcoming of this settlement was that in many ways, it failed to create the proper incentives for those actions that provided the greatest relief to the neediest consumers, instead providing credit for actions the banks would likely have taken anyway or directing relief toward consumers with larger loan balances.

Consequently, the subsequent individual bank settlement with J.P. Morgan Chase reached in November 2013, prioritizes home retention efforts, and short sales, deeds in lieu of foreclosure, and deficiency waivers are no longer eligible for credit.

Further steps were taken to prioritize targeted and effective consumer relief in the 2014 settlement agreements with Citigroup and Bank of America. Under its mortgage settlement terms, Citibank only receives credit for making principal loan forgiveness modifications in which homeowners no longer owe the bank more than their homes are

[1] See Office of Mortgage Settlement Oversight, "About the Settlement," available at https://www.jasmithmonitoring.com/omso/about-the-national-mortgage-settlement/.

worth. The Bank of America settlement goes yet a step further and requires that principal loan forgiveness modifications on Bank of America loans put homeowners back in an equity position in their homes. This type of modification – one that restores homeowner equity – is the one that best aligns the incentives of families and investors for future success and increase the likelihood of home retention over the long haul.[2]

These settlements also help to target consumer relief where it is most needed by requiring that banks direct at least half of the consumer relief (loan modifications) to hard-hit communities. Previously, while banks received extra credit for directing relief where it is most needed, they were not always required to do so.

Additionally, the settlements with Citibank and Bank of America also require banks to set aside a minimum amount of money, less than one percent of the total dollar amount, to support services provided by housing counselors and other trusted intermediaries that enable consumers to access the consumer relief to which they are entitled under the settlements. Data show that homeowners who received assistance from a certified housing counselor through the National Foreclosure Mitigation Counseling program were nearly three times more likely to receive a loan modification than homeowners who were not counseled.[3] This is not at all surprising, given the difficulty that homeowners have had in receiving assistance from mortgage servicers as well as the many consumer relief scams out there.[4]

Intermediaries also serve as important eyes and ears on the ground to ensure that banks are complying with the settlement agreements – which is not always a given. For instance, banks failed repeatedly to follow the servicing rules established by the National Mortgage Settlement, so instead of receiving relief, homeowners encountered the same

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[2] Andrew Haughwout, Ebiere Okah, and Joseph Tracy, "Second Chances: Subprime Mortgage Modification and Re-Default" Federal Reserve Bank of New York Staff Reports (2010), available at http://www.newyorkfed.org/research/staff_reports/sr417.pdf; Roberto G. Quercia and Lei Ding, "Loan Modifications and Redefault Risk: An Examination of Short-Term Impacts" *CityScape* (2009), available at http://ccc.unc.edu/contentitems/loan-modifications-and-redefault-risk-an-examination-of-short-termimpacts/

[3] Charles Calhoun, Neil Mayer, Peter Tatian, and Kenneth Temkin, "National Foreclosure Mitigation Counseling Program Evaluation: Final Report, Rounds 3 Through 5." Washington: Neighborworks America and Urban Institute (2014), available at http://neighborworks.issuelab.org/resource/national_foreclosure_mitigation_counseling_program_evaluation_final_report_rounds_3_through_5

[4] Adam Levitin and Tara Twomey, Mortgage Servicing, Yale Journal on Regulation Vol. 28.1, 2011.

runaround from their servicers that the settlement was created to remedy.[5] Housing counselors also prepare families for entering into homeownership, ensuring that they purchase an affordable home with a sustainable mortgage.[6]

Finally, while these settlements have come too late to save the five million homeowners who already lost their homes, they can do an enormous amount to restore hard-hit neighborhoods. Vacant homes continue to destabilize low- and moderate-income neighborhoods across the country, especially in markets characterized by large concentrations of distressed and low-value vacant properties. Often under-maintained and vandalized, these properties depress property values, contribute to blight and a lack of neighborhood stability, and represent a costly burden for local governments. Consequently, it is extremely helpful that the settlements with Citibank and Bank of America also provide for donations to land banks, community development financial institutions and community development funds, which help communities return these properties to productive use, stabilize neighborhoods and restore home values.

For future settlements, we believe the Department of Justice could take additional steps to strengthen consumer relief. For example, settlement dollars should be better targeted to reach particularly hard-hit neighborhoods, especially communities of color. As described above, the recent mortgage settlements with Citibank and Bank of America require banks to target some of their consumer relief toward hard-hit census tracts. These requirements were an important first step and the Department of Justice should expand upon them.

Additionally, future settlements should improve outreach efforts, especially for homeowners with limited English proficiency, so that more consumers can take advantage of the relief available to them, and consumers should be able to apply directly for this relief instead of waiting for a mortgage servicer to select their file. Housing counselors and other intermediaries can play a critical role in these outreach efforts.

We also want to underscore the importance of detailed loan level reporting about who ultimately receives relief under the settlement. At a minimum, the public should be able

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[5] Shaila Dewan, "Banks Fail to Comply with Parts of Mortgage Settlement, Report Says," *New York Times, December 4, 2013 available at* http://www.nytimes.com/2013/12/05/business/banks-fail-to-comply-withparts-of-mortgage-settlement-report-says.html?_r=0

[6] Marvin Smith, Daniel Hochberg, and William Greene, "The Effectiveness of Pre-Purchase Homeownership Counseling and Financial Management Skills," Federal Reserve Bank of Philadelphia: 2014, available at http://www.philadelphiafed.org/community-development/homeownership-counselingstudy/2014/homeownership-counseling-study-042014.pdf.

to learn about relief by census tract, with information not only about the kinds of relief, but also about the demographics of the households receiving relief.

Thank you again for the opportunity to provide some thoughts on the mortgage settlements and to underscore the critical importance of providing consumer relief for the extensive harm to families, communities, and the economy caused by the misconduct and illegal actions of mortgage lenders, servicers, and securitizers.

Mr. JEFFRIES. Thank you. Now, is it in fact the case that with respect to the Bank of America and Citigroup settlements, only .3 percent of the settlement funds were to be directed toward housing counseling? Is that true?

Mr. GRABER. That sounds about right.

Mr. JEFFRIES. Okay. And there is some dispute I gather as to whether this housing counseling is of benefit to the American people. But there are over a million homes that are still in foreclosure in America right now, correct?

Mr. GRABER. Yes. I do not have the precise numbers, but that sounds correct.

Mr. JEFFRIES. Okay. And is it true that of those who go through the National Foreclosure Mitigation Counseling Program, they are 3 times more likely to receive a loan modification? Does that sound right to you?

Mr. GRABER. That does sound right to me. It is my understanding that the folks who utilize the services of organizations that are on the HUD-approved counseling list are far more likely to stay in their home and are less likely to default.

Mr. JEFFRIES. And 70 percent, in fact, of individuals who go through counseling will stay on track in terms of their payment, a far greater number than those who do not receive this type of counseling. So I just want to thank the Department of Justice for the tremendous work you have done in securing these robust settlements, holding these financial institutions responsible for the collapse of our economy and triggering the Great Recession accountable, and for diverting some of the money legally to these organizations providing a good service. And I yield back.

Mr. MARINO. Thank you, Mr. Jeffries. The Chair now recognizes the gentleman from Texas, Congressman Ratcliffe.

Mr. RATCLIFFE. Thank you, Mr. Chairman. Mr. Graber, how long have you been at the Justice Department?

Mr. GRABER. I have been at the Justice Department since May of 2009.

Mr. RATCLIFFE. All right. I was there for a number of years as well along with the Chairman. I had the great opportunity to serve as a line level prosecutor and later as a U.S. attorney for the Eastern District of Texas. Chairman Goodlatte mentioned earlier the United States Attorney Manual that I was obligated to follow, and the obligations created under that manual to avoid any actual or perceived conflicts of interest in settlements.

And, in fact, is it not true that everyone at the Department of Justice—you, when I was there, the Attorney General—we all take an oath to remain decidedly apolitical in the enforcement and administration of the Department mission?

Mr. GRABER. Absolutely.

Mr. RATCLIFFE. All right. Now, La Raza, which was mentioned earlier by the gentleman from Michigan, which describes itself as one of the largest advocacy groups in this country, that is a decidedly political group. Would you agree with me?

Mr. GRABER. I am aware of La Raza generally. I am aware that they, especially in the lead-up to these hearings, I am now aware that they engage in political activities.

Mr. RATCLIFFE. Well, how does the direction of settlement funds or making settlement funds available to decidedly political groups like La Raza mesh with the Department of Justice's mission?

Mr. GRABER. Thank you, Congressman. As I indicated previously, under the terms of these settlements, the Department of Justice does not direct any monies to any specific organizations on the HUD-approved——

Mr. RATCLIFFE. But it makes them available.

Mr. GRABER. I am sorry?

Mr. RATCLIFFE. But it makes them available.

Mr. GRABER. Anyone who is on the list would be available under the terms of the agreement. The Catholic Charities that I mentioned earlier, Christian Legal Services, Jewish charities, the organizations that you mentioned, if they are on the list, all of those organizations—I believe there are hundreds of them—would be available. And it will be up to the financial institutions to determine which one of those organizations on the list will receive any funding.

Mr. RATCLIFFE. Does it concern you at all the appearance of impropriety in requiring banks under this settlement to make settlement funds available to activist groups?

Mr. GRABER. Thank you, Congressman. Look, I understand the concern, and that concern is why the Department did not want to be in the business of picking and choosing any specific organization that would receive funding under the terms of the settlements. Instead, the Department thought it best to use a preexisting list, the HUD-approved counseling list. This is a congressionally mandated list that has existed for decades, and there are hundreds and hundreds of organizations on that list, and to leave it within the discretion of the financial institutions to choose which one of those organizations on the list to direct funds to.

Mr. RATCLIFFE. Well, Mr. Graber, that is the problem. The Department should not be making those decisions. The Department's mission is to enforce the Constitution, correct?

Mr. GRABER. I would agree with that.

Mr. RATCLIFFE. Okay. And the Constitution provides that "no money shall be drawn from the Treasury but in consequence of appropriations made by law." Congress makes the laws, correct?

Mr. GRABER. That is correct.

Mr. RATCLIFFE. All right. And you certainly respect the separation of powers that our Constitution provides, right?

Mr. GRABER. Absolutely.

Mr. RATCLIFFE. All right. And you think that the Department of Justice should remain in the business of enforcing the laws, not making laws.

Mr. GRABER. I would agree with that, and I would say that, you know, these settlements are an example of the Department's vigorous enforcement of the laws.

Mr. RATCLIFFE. All right. Well, we will just have to disagree about that. I will yield my time back.

Mr. MARINO. Thank you, Congressman. Okay. The Chair now recognizes the gentleman from Michigan, Congressman Trott.

Mr. TROTT. Thank you, Mr. Chairman. I appreciate your testimony. You know, it looks and smells a little bit like a slush fund.

And I guess the critical question for me is when the settlements were reached with Citi, Chase, and B of A, how did they get access to the list for non-profits?

Mr. GRABER. I am sorry. Could you repeat that question?

Mr. TROTT. How did the financial institutions, they were just handed a list of the non-profits that were eligible for the money?

Mr. GRABER. I believe the HUD-approved counseling list is publicly available. It is on the website, and through the course of negotiations it was agreed that the parties would utilize that list.

Mr. TROTT. Okay. So you can state unequivocally that no attorney at Justice, the monitors of these settlements, none of those folks suggested at any time to B of A, Citi, or Chase that within this list of approved counseling agencies, there is any kind of preferred group. That is the critical question, is it not? I mean, if there was a preferred group, then we are talking about a slush fund, would you not agree?

Mr. GRABER. That is a perfectly fair question, and I am not aware of, and I would be shocked to learn, if any financial institution was ever directed to utilize any specific organization on the list. I am not aware of that at all.

Mr. TROTT. So you can understand with that apprehension why the documents that Chairman Goodlatte is looking for are so critical to this discussion. Would you agree that that would resolve this question, would it not?

Mr. GRABER. Well, I am aware of the request, and as I stated, our response is in process.

Mr. TROTT. Mr. Chairman, one of the things we need to do is we need to get folks in from B of A, Chase, and Citi and ask them when you got this settlement and you started picking who was going to get involved in the non-profit world, how did you make that decision. And if someone there contradicts what you have said, then this whole discussion is over. It is a game, set, match, and it is a slush fund.

Now, if the Justice Department thought that this money for the non-profits was so productive, and some of it is. I have dealt with non-profits in the housing counseling world for many years. Some of them do a great job. Some of them do no service to the borrower who needs that help. But if they thought it was so productive, why would they not just recommend that the President's budget allocate more money to HUD for the non-profits, and that would be consistent with the Constitution? And why would they have to have part of the settlement that the money is directed this way?

Mr. GRABER. Well, Mr. Congressman, I cannot speak to any decision with respect to the President's budget. What I can say is that through the course of the negotiations leading up to these settlements, we thought that directed funds to these types of organizations that provide housing counseling, and foreclosure mitigation, foreclosure prevention services, was a valuable part of the overall consumer relief package. You know, if through these settlements folks utilize the services provided by these housing counseling agencies and folks are able to stay in their homes, that is a good thing, and that is something that we hope can be achieved through these settlements.

Mr. TROTT. But there was another way to accomplish that, which is to have the money come into Treasury and recommend that the money be allocated accordingly in the President's budget. That would have accomplished the same result, would you not agree, and be consistent with our Constitution?

Mr. GRABER. Well, you know, that may be one hypothetical situation where funds could be allocated to third party groups, but——

Mr. TROTT. Well, the budget allocates money to non-profits under the HUD grants, so more funding in that area would have accomplished the same result.

Mr. GRABER. Mr. Chairman, I would agree with you that Congress could certainly allocate funds to these counseling agencies.

Mr. TROTT. I appreciate it. Next question. Why would there be a 2-to-1 credit? You know, in my experience, you have a borrower that has a $70,000 mortgage. The property when they bought it was worth $100,000. Now it is under water to the tune of $50,000. It is a very difficult loan modification to accomplish without some loan balance relief. Why not allocate it differently? Instead of 2-to-1 in terms of favoring potential slush fund abuses, allocate it 2-to-1 to the borrower and give credit to Bank of America twice for every dollar they allocate to help some borrower that has got a loan balance that is workable.

Mr. GRABER. So the crediting mechanisms in these settlements reflect a variety of factors, one of the most important of which is the relative expense of the various forms of consumer relief to the banks. So the reason that there is a 2-to-1 crediting on the direct donations provision that we have been discussing is because that form of relief compared to modifications of assets already on the books of the financial institutions, those directed donations are very, very expensive for the financial institutions.

It is my understanding—I cannot speak for the banks—but it is my understanding that the modifications of underwater loans, the type that you just mentioned, those types of modifications are far less expensive to the banks than the directed donations provision.

Mr. TROTT. Thank you, sir.

Mr. MARINO. The gentleman's time has expired. The Chair recognizes now the gentleman from Georgia, Congressman Collins.

Mr. COLLINS. Thank you, Mr. Chairman, and good to see you there leading us in this Committee now. There are several things that confuse me, Mr. Graber, as we have been starting this. One, it is interesting you have been asked several times about, you know, the chain of command, and where the orders come from, and how did this get in here. Let me make sure. The DOJ, you all actually negotiated these settlements, correct?

Mr. GRABER. Yes.

Mr. COLLINS. Okay. Well, I am glad we are at least starting on this foundational level here. So somebody had to know something that was going on on the direction of these settlements, correct? I am beginning to believe, and judging by what you had said earlier, it was like there was a group. It is almost like maybe we will walk down the hall of the DOJ and say, hey, we are going to a settlement discussion, who wants to throw in some information. Somebody had to have been giving some direction here, and to be honest, your answers are not clear.

Let us just start here. The JPMorgan settlement did not have the mandatory donation provision, correct?

Mr. GRABER. That is correct.

Mr. COLLINS. Okay. But yet Citi and Bank of America did, correct?

Mr. GRABER. That is correct.

Mr. COLLINS. Let me ask you this. Why did you decide to depart from the previous precedent or precedents of previous agreements that came under the Bush Administration that provided that only money left over after all consumer injury had been redressed could go to third party groups?

Mr. GRABER. I am sorry. Could you repeat the question?

Mr. COLLINS. Previous precedent was that only money left over after all injury or redress was there could that be then redressed to a third party group. Who made the change in that decision, or is this another group decision that really nobody knows?

Mr. GRABER. So as I stated previously, I am not aware of any direct order or any specific, you know, decision by an individual to go with the mandatory minimum provision. I was——

Mr. COLLINS. So where did it come from? Was it just a kumbaya moment in the negotiations? And I am not trying to be funny here, but, I mean, I have sat through negotiations. I am attorney. I have sat through many negotiations. You have sat through many negotiations. At some point in time something had to give here. Something had to be interjected into the process to say, hey, here is a good idea, or, hey, here is a bad idea. Where did that come from?

Mr. GRABER. So as I stated earlier, there was a team, which consisted of a dozen or more officials from Department of Justice, and HUD, and other folks from the government, who were responsible for negotiating the consumer relief provisions. On any given day they were discussing dozens and dozens of details in each of these settlements. It is my understanding that——

Mr. COLLINS. Did Department of Justice bring this up, did HUD bring this up, or did the banks bring this up? How did it get brought up?

Mr. GRABER. If I may, it is my understanding at a certain point, you know, the team determined that it was the best course of action to put in the mandatory minimum provision. It is not my understanding that there was any decision——

Mr. COLLINS. Mr. Graber, look, I have a minute 40 left in my conversation here.

Mr. GRABER. I am sorry?

Mr. COLLINS. I have a little over a minute left, a minute and a half. We are not going to run the ball out here. At this point in time, someone at the table, because it was not the JPMorgan. Somebody at the table, either DOJ, HUD, this wonderfully amorphous group that you keep talking about, somebody ought to say, well, let us put a minimum in here or let us send these to third parties. Was that DOJ's idea? Was it HUD's idea? Where did it come from? And I am going to stop right here. If you tell me about this amorphous group, everybody having a good idea again, then just say I do not know. I am giving you a chance.

Mr. GRABER. I do not know——

Mr. COLLINS. Thank you.

Mr. GRABER [continuing]. If there was any specific individual who, you know, who brought it up first——

Mr. COLLINS. And if was your idea, take credit for it. I mean, this is amazing. Let us go about it real quickly, 47 seconds left. I want to switch. The monitoring process you talked about, it only deals with the banks, okay? And we talk about the banks, making sure that they live up to their agreements and their end of this. DOJ does not have any monitors in place to ensure that if these monies go to intended groups that they are actually using it for the purposes stated. Is that not a concern of DOJ in making these agreements, that they would go to third party groups, but your monitors only monitor the bank that they gave them the money, no that the intended result was going to happen.

Mr. GRABER. Actually it is my understanding that the monitor will actually oversee the use of these funds by third parties——

Mr. COLLINS. But that was not your earlier testimony. Your earlier testimony was that the monitors were to monitor the banks, that the money went to where it was supposed to go, and they would do the audit to make sure they got the money so they could get properly credited in that process. And also any research that we have done is that there is no DOJ monitoring to do that for the third party groups.

Mr. GRABER. Absolutely. The monitor will oversee the allocation of the funds from the banks, including allocation under these provisions to third parties. And it is my understanding that if the third parties were to use the funds in a way that is inconsistent with the terms of the agreement, the monitor would be responsible for catching that. And the monitor would not credit the bank for the funds that went out the door on that.

Mr. COLLINS. But, again, that is contradictory to some of your testimony. With that, Mr. Chairman, there are many, many questions here left to go. But with that, I yield back.

Mr. MARINO. Thank you, Congressman. The Chair now recognizes the gentleman from Michigan, Congressman Bishop.

Mr. BISHOP. Thank you, Mr. Chairman. Thank you, Mr. Graber, for your testimony. Is it the practice of the Department of Justice to send one person to a hearing like this?

Mr. GRABER. I could not tell you the answer to that. It is the practice today certainly.

Mr. BISHOP. It just seems to me that the gravity, the weight of what we are talking about today would require that you would send some of your folks over. It is frustrating to sit here and hear "I do not know" over and over and over again on questions that, very frankly, should be answered, you know, off the top of your head. On some of these issues I am sure there are folks that have direct understanding and knowledge of these issues, and it is frightening as a citizen to sit here. It is angering as a Member to sit here and hear this banter back and forth and hear very important questions, and not get specific answers. The answer should never be "I do not know."

I noted in your testimony, and as a former prosecutor myself, I consider this laudable because I do believe that prosecutors have a responsibility to stand up on behalf of victims. You indicated in your testimony that the DOJ was securing relief that "likely could

not have been ordered by the court even if the government had prevailed at trial.'' Was that your statement?

Mr. GRABER. That is correct.

Mr. BISHOP. I think that is wonderful that the Department of Justice has that kind of resolute interest in making sure they secure, you know, the proper level of relief for each one of its consumers. But does that not scare you a little bit or should it not scare us a little bit to think that the Department of Justice has that ability to secure that kind of justice outside the court system over and beyond what we would have at trial, for example?

Mr. GRABER. Thank you, Congressman. The settlements that we entered into here, namely pre-litigation, out of court settlement, is very much consistent with the Department's authority to compromise claims on behalf of the United States. And the Department enters into settlements like this all the time, every day, in fact. So I do not think there is anything unusual about that.

Mr. BISHOP. It is not unusual for the DOJ to have more authority than someone else would have in a regular court proceeding?

Mr. GRABER. Well, no, I would not necessarily agree with that. I just think that the fact that this settlement occurred out of court, you know, prior to litigation is consistent with the Department's authority, and is, quite frankly, typical. And I would also say that it is not unusual for parties to reach agreements to compromise claims that contemplate forms of relief that may not have been able to be awarded by a court.

Mr. BISHOP. So it is the very threat of the DOJ, the heavy hand of government, to come in that could probably extract a better concession, a better settlement than you could in court. I mean, that is a rather imposing threat to level on someone, is it not?

Mr. GRABER. I would say that we do not know what a court may or may not have done if we had decided to litigate these cases.

Mr. BISHOP. All right. The Bank of America settlement, just switching gears here. The Bank of America settlement requires the bank to set aside $490 million to cover potential consumer tax liability. Was that something that the DOJ suggested?

Mr. GRABER. Yes, I believe that that was something that the Department suggested and certainly the Department supported.

Mr. BISHOP. Did the DOJ also want a similar provision in the Citi settlement, which was concluded I think just before that, a month earlier?

Mr. GRABER. I do not recall specific discussions about, you know, that specific term or a potential term in the course of the Citi negotiations. I should also point out that, look, in the lead-up to these settlements, again, I mean, the reality is that there were dozens and dozens of officials who were involved. There were dozens, if not hundreds, of meetings, sometimes simultaneous meetings. Sitting here today, the fact of the matter is that I was not in every one of those meetings.

Mr. BISHOP. Thank you, sir. Yield back.

Mr. MARINO. Thank you. Deputy Graber, thank you for being here. You are excused. And we now call the second panel to today's hearing. Thank you, sir.

Mr. GRABER. Thank you.

Mr. MARINO. Before you sit down, could I ask the panel to please stand, to raise your right hand?

Do you swear the testimony that you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

[A chorus of ayes.]

Mr. MARINO. Let the record reflect that the witnesses have affirmed their testimony. Thank you, ladies and gentlemen, for being here.

I am going to start with a brief introduction of our panel witnesses and get right to the questions. We are in a hard-pressed time to be out of here in about 45 or 50 minutes.

Mr. Paul Larkin is a senior research fellow and director of the Rule of Law Initiative Project for the Heritage Foundation, specializing in countering abuse of Federal criminal law. Mr. Larkin worked at the U.S. Department of Justice as an assistant to the Solicitor General and as a counsel in the Criminal Division's Organized Crime and Racketeering Section. During his time at the Environmental Protection Agency, he was a special agent and an acting director for the Criminal Enforcement Branch. Mr. Larkin also served as counsel to the Senate Judiciary Committee and was the chief of the Crime Unit under panel chairman, the Honorable Orrin Hatch.

Throughout his 25 years of practice, Mr. Larkin has argued before the Supreme Court in 27 cases. He is a graduate of Stanford Law School and a former law clerk for Judge Robert H. Bork on the U.S. Court of Appeals for the D.C. Circuit. Welcome, sir.

Mr. Ted Frank has won millions of dollars for consumers and shareholders through the non-profit Center of Class Action Fairness, which he founded in 2009. Mr. Frank has argued and won several landmark appellate cases protecting consumers from unfair class action settlements. His work in this area has been profiled by, among others, the Wall Street Journal, Forbes, the National Law Review, the ABA Journal, and The American Lawyer. He has testified before Federal and State legislative subcommittees multiple times about class action conflicts of interests and settlements and about legislative victim compensation programs.

Mr. Frank is a graduate of the University of Chicago Law School and a former law clerk to the Honorable Frank H. Easterbrook of the U.S. Court of Appeals for the 7th Circuit. Welcome, sir.

Mr. FRANK. Thank you.

Mr. MARINO. Ms. Mrose is the CEO of Compass Films of New York LLC. Her work focuses on the housing industry and the interaction between government, banks, housing advocates, and the economy. Her experience includes co-hosting a talk radio program and research on regulations issued by the Department of Housing and Urban Development.

Ms. Mrose is a graduate of Tufts University's Fletcher School of Law and Diplomacy, and welcome, ma'am.

Ms. MROSE. Thank you.

Mr. MARINO. And I am sorry, Professor White, but I do not have your background. If someone gives it to me at some point I will read it. I apologize for it for not being here, but I do want to welcome you, and thank you for being here today, and we will get to

your background when it is handed to me. I see it is right here. Thank you.

Professor Alan White joined the faculty of CUNY School of Law in 2012. He teaches consumer law, commercial law, bankruptcy, comparative private law, and contracts. The latter was not my favorite in law school. He is a nationally recognized expert on credit regulation in the residential mortgage market. Professor White is a past member of the Federal Reserve Board's Consumer Advisory Council, a member of the American Law Institute, and is currently serving as reporter for the Uniform Law Commission's Project on a residential real estate foreclosure statute.

He is quoted frequently in the national media, including the New York Times, the Wall Street Journal, and the Washington Post in connection with his research on the foreclosure crisis. He has published a number of research papers and articles on housing credit and consumer law issues, and has testified before Congress and at Federal agency hearings on the foreclosure crisis bankruptcy reform and predatory mortgage lending.

Before becoming a full-time teacher, Professor White was a supervising attorney at the North Philadelphia office of Community Legal Services, Inc., and was also a fellow and consultant with the National Consumer Law Center in Boston, and an adjunct professor with Temple University Law School and Drake University School of Law. His legal services practice includes representation of low income consumers in mortgage foreclosures, class actions, bankruptcies, student loan disputes, and real estate matters.

Mr. White received his B.S. from the Massachusetts Institute of Technology and his J.D. from the New York University School of Law. Welcome, sir.

Mr. WHITE. Thank you.

Mr. MARINO. Each witness' written statement will be entered into the record in its entirety. I ask that each witness summarize his or her testimony in 5 minutes or less. And to help you with staying within that time, you see the lights in front of you. If the light switches from green to yellow, it means you have a minute left, and when it gets to red I will politely tap here to give you an indication if you would please wrap up.

The Chair now recognizes Mr. Larkin for his opening statement. Sir?

TESTIMONY OF PAUL J. LARKIN, JR., SENIOR LEGAL RESEARCH FELLOW, EDWIN MEESE III CENTER FOR LEGAL AND JUDICIAL STUDIES, THE HERITAGE FOUNDATION, WASHINGTON, DC

Mr. LARKIN. Mr. Chairman, Ranking——

Mr. MARINO. The microphone in front of you, you have to push the button there, and the light should come on.

Mr. LARKIN. My mistake. Sorry.

Mr. MARINO. That is quite all right. I do it.

Mr. LARKIN. Mr. Chairman, Mr. Ranking Member, it seems to be common ground that if these checks that were due to the United States were actually deposited in the Treasury, the Justice Department would lack any authority to require that they then be turned over to anyone else. Not only would they not have possession of the

check, the law—that is, the Constitution as well as the Anti-Deficiency Act and the Miscellaneous Receipts Act—would prohibit the Department of Justice from handing out this money.

So the only dispute is whether the Justice Department can engage in the same result simply by directing the bank to do it. In other words, once the Department has deposited the check, they could not give the money to these groups. So instead, what the Department has done is tell the bank do not give me the check. Give the check to these private parties.

Now, if you want to understand this, flip the facts around. Suppose this were a settlement and the Department was paying the banks. The lawyer, who is handling the case for the banks, could not tell the Department do not write all of the checks to me. Write some of the checks to a charity of my choosing or a charity of your choosing. The lawyer for a client cannot give away the money that belongs to the client, and in this case, the Department represents the United States, and they are not allowed to give away money that belongs to the United States unless there is express statutory authority to do it, and there is none here.

What aggravates this problem even more is that you have these sorts of settlements gradually coming into wider and wider use ever since the Anderson case was resolved with everyone being a loser. Why is that a problem? Because oftentimes there is no judicial involvement whatsoever. These agreements often are a means of disposing not of charges or a lawsuit that has already filed. They are a means often of disposing of charges or a lawsuit before any are filed. So there is no judicial involvement whatsoever. You have an agreement entirely between the lawyers for the United States and the lawyers for other parties. And in this agreement they are trying to engage in what is for all intents and purposes a sham transaction to avoid depositing all of the money that is due to the taxpayers of the United States into the account that the Treasury maintains, that Congress thereafter can decide how it will be spent.

After all, Article 1 says that no appropriations can be made—or excuse me—no money can be taken from the Treasury except pursuant to an appropriation. It is designed to prevent the President from using the Treasury as if it were his own personal account. Only Congress can authorize him to spend that money. When the money then comes into the government, the Miscellaneous Receipts Act requires that it be deposited into the Treasury with a few exceptions, none of which are applicable to housing cases or the ones we have here.

Once the money is then deposited, it is up to the elected members to decide how to spend it. If they want to give it to these organizations, that is perfectly proper. When I worked for Senator Hatch, the Judiciary Committee worked on legislation to authorize money to be given to the Boys and Girls Clubs. Why? Because the Committee thought that would advance the welfare of the Nation, but only if the Committee had authorized it and then the appropriators had appropriated the money could that be done.

And it does not matter whether this is done in a Democratic or Republican Administration. As my paper and the paper by the Chamber of Commerce point out, Republicans have done this be-

fore, and when they did, they were just as wrong. And it does not matter that the money goes to an organization that may be a valuable mechanism for disposing of funds. It does not matter if it goes to Catholic Charities. It does not matter if it goes to any Christian organization. It does not matter if it goes to any organization whatsoever. If it is an organization that is not authorized by Congress to receive the money, the expenditure is impermissible.

The same ethics rules should apply to government lawyers in this context that would apply to private parties. They act on behalf of the United States. In so doing, they are not allowed to make their own decisions. And by the way, if you want to find out who made this decision, I would start by looking at the two agreements because if you look at the two agreements, what you will see is that they were signed for the United States by Tony West, the Associate Attorney General, who is the number three person in the Department.

So in all likelihood, he knew what these provisions were. And given the size of this, unless he was irresponsible, he also brought that to the attention of his superiors in the Department. You do not enter into an agreement like this without telling your boss what you are about to do.

I am glad to answer any questions you may have.

[The prepared statement of Mr. Larkin follows:]

"CONSUMERS SHORTCHANGED? OVERSIGHT OF THE JUSTICE DEPARTMENT'S MORTGAGE LENDING SETTLEMENTS"
TESTIMONY BEFORE THE HOUSE COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON REGULATORY REFORM, COMMERCIAL AND ANTITRUST LAW
FEBRUARY 12, 2015

WRITTEN SUBMISSION BY
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"CONSUMERS SHORTCHANGED? OVERSIGHT OF THE JUSTICE DEPARTMENT'S MORTGAGE LENDING SETTLEMENTS"
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FEBRUARY 12, 2015
PAUL J. LARKIN, JR.

Mr. Chairman, Mr. Ranking Member, Members of the Subcommittee:

My name is Paul J. Larkin, Jr. I currently am a Senior Legal Research Fellow at The Heritage Foundation. Most of my career has involved working in the criminal justice system in one capacity of another. For example, I worked at the Department of Justice in the Organized Crime and Racketeering Section of the Criminal Division and in the Office of the Solicitor General. I also was Counsel to the Senate Judiciary Committee when Senator Orrin Hatch was the Chairman. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

Thank you for the opportunity to testify about third-party payment requirements in government settlement agreements. I have previously discussed this issue in a Heritage Foundation paper and in a law review article that were both published last year.[1] My opinion is that third-party payment requirements should not be included in a plea bargain, civil settlement, and nonprosecution or deferred prosecution agreement unless an act of Congress expressly and specifically authorizes the government to impose any such obligation.[2] That is true for several reasons:

First, the Justice Department lacks the statutory authority to hand over government funds to parties of its own choosing. Second, the practice of required third-party contributions is inconsistent with the federal laws that supply financial assistance to the victims of crime. Third, third-party contribution requirements circumvent the constitutional process for appropriating taxpayer dollars. Fourth, this practice denies the public the opportunity to know how public funds are spent and to hold elected officials accountable for their choices because it enables Representatives and Senators to shirk their fiscal responsibilities. Fifth, third-party contribution require-

[1] *See* Paul J. Larkin, Jr., *The Problematic Use of Nonprosecution and Deferred Prosecution Agreements to Benefit Third Parties*, The Heritage Foundation, Legal Memorandum No. 141 (Oct. 23, 2014), http://www.heritage.org/research/reports/2014/10/the-problematic-use-of-nonprosecution-and-deferred-prosecution-agreements-to-benefit-third-parties; Paul J. Larkin, Jr., *Funding Favored Sons and Daughters: Nonprosecution Agreements and "Extraordinary Restitution" in Environmental Criminal Cases*, 47 LOYOLA L.A. L. REV. 1 (2013).

[2] The concerns addressed here are the same whether the disposition is a plea bargain, nonprosecution or deferred prosecution agreement, or a civil settlement, although those concerns are more acute when criminal charges are a reality or a possibility. It is unknown how many of these types of settlements could have been brought as a criminal prosecution, but it is likely that some could have been criminal cases. *See, e.g.*, Bank of America Settlement ¶¶ C.I., at 2 (Aug. 18-20, 2014) ("Bank of America and its subsidiaries originated residential mortgages using inflated appraisals and fraudulently sold those loans to the [government-sponsored enterprises] with misrepresentations as to the loans' quality[.]); id. C.ii (qui tam action alleged that Countrywide and Bank of America "fraudulently sold defective residential mortgage loans originated by Countryside's Consumer Markets Division and later Bank of America to the [government-sponsored enterprises] with misrepresentations as to the loans' quality[.]").

ments are rife with opportunities for political cronyism because they allow the Justice Department to pick-and-choose among private organizations as to which ones will receive federal funds without any guidance from Congress or any oversight by the Judiciary or Appropriations Committees in each chamber. Sixth, third-party contribution requirements are not necessary for plea bargains, civil settlements, and nonprosecution or deferred prosecution agreements to work as a means of disposing of criminal or civil cases.

I. THIRD-PARTY PAYMENT REQUIREMENTS ARE AN EMERGING FEATURE OF GOVERNMENT PLEA OR SETTLEMENT AGREEMENTS

Federal prosecutors enjoy almost unlimited discretion to decide whether to indict or sue a defendant, what charges or claims should be brought, whether to dispose of a case before trial via a plea bargain or civil settlement, and, if so, what the terms of that disposition should be. For all practical purposes, as long as prosecutors do not let impermissible factors such as race or religion influence their decisions, they have the prerogative to decide whether and how to initiate or terminate any particular case.[3]

Plea bargains and settlements are traditional ways to dispose of a case, and the Subcommittee members doubtless are familiar with those processes. Recently, however, a new disposition has emerged: nonprosecution and deferred prosecution agreements (N/DPAs). Before addressing whether third-party contribution requirements are a sound exercise of settlement authority, it may be useful to say a few words about this new dispute resolution mechanism.

Nonprosecution agreements resolve potential criminal charges in a manner that resembles a plea bargain or a civil settlement, but do not involve the entry of a judgment enforceable by a court. Deferred prosecution agreements are similar, but arise only after a charge is filed, a charge that the government is willing to consider dismissing if the defendant satisfactorily performs the terms of an agreement that avoids the need for a trial. The two dispositions also can perhaps be combined into one. That would occur when the government files one charge out of perhaps dozens or more that it could bring.

Ever since the Arthur Andersen case[4] ended in 2005 with everyone being a loser—Arthur Andersen, its innocent employees, and the government—the federal government has regularly disposed of corporate criminal prosecutions through N/DPAs. N/DPAs may or may not be reasonable ways to dispose of criminal charges or civil claims. They have become quite controversial;[5] they raise several troublesome public policy issues; and, some highly learned and respected

[3] *See, e.g.*, United States v. Armstrong, 517 U.S. 456 (1996) (discussing the proof necessary to establish that a charge was brought due to invidious discrimination); Rinaldi v. United States, 434 U.S. 22, 30 (1977) (stating that, when the government seeks to dismiss an indictment or information, '[t]he salient issue . . . is not whether the decision to maintain the federal prosecution was made in bad faith but rather whether the Government's later efforts to terminate the prosecution were similarly tainted with impropriety."); SEC v. Citigroup Global Markets, Inc., 752 F.3d 285 (2d Cir. 2014) (applying a similar standard to determine whether the SEC and a private party should be allowed to dispose of a civil case via a consent decree; "the proper standard for reviewing a proposed consent judgment involving an enforcement agency requires that the district court determine whether the proposed consent decree is fair and reasonable, with the additional requirement that the 'public interest would not be disserved.'" (citation omitted)).

[4] *See* Arthur Andersen LLP v. United States, 544 U.S. 696 (2005).

[5] *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-110, CORPORATE CRIME: DOJ HAS TAKEN STEPS TO BETTER TRACK ITS USE OF DEFERRED AND NON-PROSECUTION AGREEMENTS, BUT SHOULD

authorities, such as Professor Richard Epstein, have leveled persuasive criticisms of using them to dispose of criminal cases.[6] One often-voiced criticism is that N/DPAs allow the government

EVALUATE EFFECTIVENESS (Dec. 2009), *available at* http://www.gao.gov/assets/300/299781.pdf; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-260T, CORPORATE CRIME: PROSECUTORS ADHERED TO GUIDANCE IN SELECTING MONITORS FOR DEFERRED PROSECUTION AND NON-PROSECUTION AGREEMENTS, BUT DOJ COULD BETTER COMMUNICATE ITS ROLE IN RESOLVING CONFLICTS (Nov 19, 2009), *available at* http://www.gao.gov/assets/130/123772.pdf; U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-636T, CORPORATE CRIME: PRELIMINARY OBSERVATIONS ON DOJ'S USE AND OVERSIGHT OF DEFERRED PROSECUTION AND NON-PROSECUTION AGREEMENTS (2009), *available at* http://www.gao.gov/assets/130/122853.pdf; BRANDON GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS (2014); John C. Coffee, Jr., *Deferred Prosecution: Has It Gone Too Far?*, NAT'L L.J., July 25, 2005, at 13; James R. Copland, *The Shadow Regulatory State: The Rise of Deferred Prosecution Agreements*, *in* CIVIL JUSTICE REPORT 2012 (Ctr. For Legal Policy at the Manhattan Inst., 2012); Richard A. Epstein, *Deferred Prosecution Agreements on Trial: Lessons from the Law of Unconstitutional Conditions*, *in* PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT 52–57 (Anthony S. Barkow & Rachel E. Barkow eds., 2011); Richard A. Epstein, Op-Ed., *The Deferred Prosecution Racket*, WALL ST. J., Nov. 28, 2006, at A14; Benjamin S. Greenblum, Note, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863 (2005); Vikramaditya Khanna & Timothy L. Dickinson, *The Corporate Monitor: The New Corporate Czar?*, 105 MICH. L. REV. 1713 (2007); Leonard Orland, *The Transformation of Corporate Criminal Law*, 1 BROOK. J. CORP. FIN. & COM. L. 45, 45 (2006).

Professor Epstein and other commentators have criticized the government's use of N/DPAs to evade accountability. *See* Epstein, *supra*; Larkin, *supra* note 1, at 5 & nn.5-6 (collecting authorities). A similar problem also exists in the administrative process, where the government seeks to use informal regulatory devices, rather than the APA rulemaking process. The legality of an agency's use of informal actions to escape APA accountability, however, is beyond the scope of this hearing. For discussions of that problem, see, *e.g.*, Jerry Brito, *"Agency Threats" and the Rule of Law: An Offer You Can't Refuse*, 37 HARV. J. L. & PUB. POL'Y 553 (2014); Henry N. Butler & Nathaniel J. Harris, *Sue, Settle and Shut Out the States: Destroying the Environmental Benefits of Cooperative Federalism*, 37 HARV. J. L. & PUB. POL'Y 579 (2014); John D. Graham & James W. Broughel, *Stealth Regulation: Addressing Agency Evasion of OIRA and the Administrative Procedure Act*, 1 HARV. J. L. & PUB. POL'Y: FEDERALIST 30 (2014); John D. Graham & Cory R. Liu, *Regulatory and Quasi-Regulatory Activity Without OMB and Benefit-Cost Review*, 37 HARV. J. L. & PUB. POL'Y 425 (2014); Nina A. Mendelson & Jonathan B. Wiener, *Responses to Agency Avoidance of OIRA*, 37 HARV. J. L. & PUB. POL'Y 447 (2014); Stuart Shapiro, *Agency Oversight as "Whac-a-Mole": The Challenge of Restricting Agency Use of Nonlegislative Rules*, 37 HARV. J. L. & PUB. POL'Y 523 (2014).

[6] In an article published in 2014 by the Heritage Foundation, Professor Richard Epstein argued that the government's unregulated discretion to dispose of cases without a trial or plea agreement—that is, without any involvement of the federal judiciary—leads to various untoward results in white-collar cases involving large corporations. *See* Richard A. Epstein, *The Dangerous Incentive Structures of Nonprosecution and Deferred Prosecution Agreements*, THE HERITAGE FOUNDATION LEGAL MEMO NO. 129 (June 26, 2014), http://thf_media.s3.amazonaws.com/2014/pdf/LM129.pdf. A major problem is that N/DPAs severely skew the incentives that each party has to let a jury (or judge) decide the merits of the government's claims at a trial. The collateral consequences that a corporation can suffer from simply being convicted of a crime, or in some instances perhaps just being charged—for example, increased costs in the capital markets, the inability to contract with the federal government, or the suspension of professional licenses—often may exceed whatever monetary penalty that a court could impose on the corporation after conviction. The result is that the N/DPA process effectively inverts the incentive structure otherwise envisioned by the criminal justice system. Using N/DPAs to resolve a potential criminal case front-loads all

to create a new paradigm of corporate governance—a form of "regulation by litigation"—that enables the government to use settlements as a means of obtaining supervisory authority over a corporation that no statute and no regulation authorizes and that a federal district court could not award to the government were a corporate defendant tried and found guilty.[7] One issue that is especially problematic is the one that this committee has decided to address: namely, the requirement that an actual or potential criminal or civil defendant pay money to a third party who could not be deemed a "victim" under the federal laws granting crime victims the opportunity for restitution.

II. THIRD-PARTY PAYMENT REQUIREMENTS ARE AN UNAUTHORIZED CONDITION ON THE DISPOSITION OF A CRIMINAL CASE

Federal law limits the sentencing authority of a federal court to whatever penalties are affirmatively authorized by law. In 1916 in *Ex parte United States*,[8] the Supreme Court of the United States held that a federal district court has only whatever sentencing authority Congress has granted the court by statute, regardless of how reasonable a newly-invented disposition may be. In that case, rather than impose the mandatory sentence dictated by statute, the federal trial judge decided to place the defendant on probation, which then had recently become a novel way to sentence a convicted defendant. Allowing a court to craft its own sanctions, the Court concluded, would authorize the court to disregard the legislative judgment as to what penalties are appropriate for a crime, authority that Article I of the Constitution vests in Congress.[9]

The ruling in *Ex parte United States* is instructive here because no act of Congress authorizes the government to require the payment of money to third-parties to dispose of a criminal or civil case, regardless of whether the government or the defendant decides who should receive those funds and how much the gift should be. To start with, these payments are not "fines."[10] A

of the costs to the corporation because the charge itself can serve as a death sentence, as prosecutors know. *See* Larkin, *supra* note 1, at 18 & n.47. Indeed, ever since the Arthur Anderson case the government and corporate defendants have avoided trials, albeit for very different reasons. Corporate defendants fear being charged or convicted because either one can amount to a "corporate death sentence." The government wishes to avoid a trial because the government is limited in the relief that it can obtain after conviction to only those penalties authorized by Congress. *See Ex parte* United States, 242 U.S. 27, 42-43 (1916); Larkin, *supra* note 1, at 27-28. The government may find those penalties inadequate, however, because they do not permit it to engage in "regulation by prosecution"—the practice by which the government seeks to alter the conduct of a business without going through the Article I lawmaking process or the notice-and-comment process. *See supra* note 5.

[7] *See, e.g.*, Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 858 (2007) ("[S]tructural reform is a new goal for federal criminal law."); Peter J. Henning, *The Organizational Guidelines: R.I.P.?*, 116 YALE L.J. POCKET PART 312, 315 (2007), http://yalelawjournal.org/images/pdfs/528.pdf ("The purpose of corporate prosecutions is not to punish but instead to change corporate cultures through agreements that deal directly with internal governance. While it is questionable whether the government has the expertise to tell corporations how best to govern themselves, the focus on how businesses will operate in the future is now a central feature of corporate criminal investigations.").

[8] 242 U.S. 27 (1916).

[9] *Id.* at 42-43.

[10] *See* Larkin, *supra* note 1, at 35-36.

fine is a penalty paid by a convicted offender to the federal government. An N/DPA or a settlement substitutes for a conviction, and compulsory charitable contributions go to third parties, not the federal treasury. Compulsory charitable contributions also are not restitution.[11] Federal courts lack inherent authority to award restitution, and the relevant statutes limit restitution to cases tried to a conviction.[12]

A corporation cannot be imprisoned, so the principal concern of any corporation under a criminal or civil investigation is the optimal dollar-and-cents resolution of the matter. If the cost of agreeing to a N/DPA or settlement is less than the cost of being charged or sued and convicted (discounted by the strength of the defendant's proof of its innocence), which is usually the case, the corporation will agree to whatever the government offers in order to make the entire problem go away. What a corporation is concerned with is the amount of whatever check it has to write, not the name of the payee. A dollar paid to Peter costs as much (or as little) as a dollar paid to Paul.[13] The result is two-fold: the corporation is indifferent as to the recipient of a payment, and the Justice Department has unfettered discretion to decide who will receive that money. That combination can pose a real problem, which has largely gone unnoticed.

Ordinarily, the Department would deposit into the U.S. Treasury whatever checks it receives to resolve a case, which enables Congress to later specify the purposes for which it can be spent. Instead, the Department has occasionally required corporations to contribute to different charitable organizations of the government's (or, as here, the corporation's) choosing.[14] The practice of identifying third-party recipients of monies that a corporation pays out in an N/DPA or settlement is tantamount to dispensing taxpayer funds to whatever particular recipient the Justice Department (or its designee) selects. That practice raises important public policy issues that neither Congress nor the federal courts has yet addressed.[15]

III. THIRD-PARTY PAYMENT REQUIREMENTS ARE OBJECTIONABLE ON SEVERAL PUBLIC POLICY GROUNDS

The government and a defendant could find third-party contribution requirements mutually valuable. Requiring a target to make a charitable contribution enables the government to evade statutory limitations on the amount of fines that could be imposed if the prosecution believes that the statutory cap provides an insufficient penalty.[16] The government may find that such conditions have considerable public relations value, particularly in the community benefitting from them. A corporate target also might jump at the opportunity to engage in a charitable endeavor. The requirement may enable a senior corporate officer to make a corporate contribution to a preferred charity that the board of directors would never approve. Moreover, the contribution may have important public relations value for the corporation as well. In the short run, to be sure, a

[11] *See id.* at 135-36.

[12] *See id.*

[13] The rule would be different if the corporation could claim a tax deduction for making a D/NPA payment, but the government often requires a corporation to waive any such claim. *See id.* at 8.

[14] *See id.* at 7.

[15] *See id.* at 29-47.

[16] *See, e.g.*, Alan T. Harland, *Monetary Remedies for the Victims of Crime: Assessing the Role of the Criminal Courts*, 30 UCLA L. REV. 52, 125 (1982).

corporation will want to reduce publicity and put the entire matter behind it, but a corporation may put a different spin on a nonprosecution agreement in the long run. Once the dust settles from the criminal investigation and memories dim, a corporation could attempt to portray itself favorably as having contributed to a recognized charity—of course, without mentioning the event triggering that contribution.

That being said, third-party contribution requirements are objectionable on several grounds. Those flaws outweigh any benefits that they may have.

First, the Justice Department lacks the statutory authority to hand over government funds to parties of its own choosing. Any sum that the government demands that a corporation hand over to a private party is money that the corporation would otherwise pay into the federal treasury, which would help underwrite the general costs of running the government. The result is a give-away of federal funds, a give-away that burdens taxpayers by requiring them to make up for the amount given to favored recipients.

Second, the practice of required third-party contributions is inconsistent with the federal laws that supply financial assistance to the victims of crime. There are several federal statutes addressing the needs of victims of crime: e.g., the Victim and Witness Protection Act of 1982,[17] the Victims of Crime Act of 1984,[18] the Mandatory Victims Restitution Act of 1996,[19] and the Crime Victims Rights Act of 2004.[20] The 1984 act provides that, with certain exceptions—not applicable to housing settlements—"all fines that are collected from persons convicted" of federal crimes "shall be deposited" into "a separate account" to be known as the Crime Victims Fund[.]"[21] Congress has also directed that the Crime Victim Funds "shall be available only for" a few specific purposes: (1) child abuse prevention and treatment grants; (2) the victim assistance programs that exist at the Federal Bureau of Investigation, at the Department of Justice, and in the U.S. Attorney's Offices,[22] programs that provide services for crime victims "through victim coordinators, victims' specialists, and victims' advocates"; (3) the training of state victim crime compensation program personnel; (4) evaluation, training, and technical assistance for "eligible crime victim assistance programs"; (5) "a Victim Notification System"; or (6) an antiterrorism

[17] Pub. L. No. 97-291, 96 Stat. 1248 (1982) (codified, as amended, at 18 U.S.C. § 3663 (2006)).

[18] Pub. L. No. 98-473, Tit. II, § 1402, 98 Stat. 2170 (codified, as amended, at 42 U.S.C. §§ 10601-10608 (2012)) .

[19] Pub. L. No. 104-132, 110 Stat. 1227 (codified as 18 U.S.C. §§ 3556, 3663–64 (2006)).

[20] Pub. L. No. 108-405, 118 Stat. 2260 (2004), enacted as § 2 of the Justice for All Act of 2004 (codified, as amended, at 18 U.S.C. § 3771 (2006)).

[21] 42 U.S.C. §§ 10601(a) & (b)(1). The exceptions relate to matters such as fines available to the Secretary of the Treasury pursuant to the Endangered Species Act or the Lacey Act, and fines paid into the railroad unemployment insurance account, the Postal Service Fund, the navigable waters revolving fund, and the county public schools funds pursuant to various federal laws. *Id.* § 10601(b)(1)(A) & (B).

For the convenience of the Members, I have reprinted the text of 42 U.S.C. §§ 10601 in Appendix B below.

[22] *See, e.g.*, FBI, VICTIM ASSISTANCE, http://www.fbi.gov/stats-services/victim_assistance; DEP'T OF JUSTICE, OFFICE OF JUSTICE PROGRAMS, OFFICE FOR VICTIMS OF CRIME, http://ojp.gov/ovc/; DEP'T OF JUSTICE, OFFICES OF THE UNITED STATES ATTORNEYS, VICTIMS RIGHTS & SERVICES, http://www.justice.gov/usao/priority-areas/victims-rights-services.

emergency reserve for the victims of 9/11.[23] Those laws demonstrate that Congress sought to limit payments to *actual, proven victims of crimes*, not to individuals or organizations that may have suffered some harm from unproved crimes or from civil wrongs, and certainly not to parties who have suffered no harm themselves.

Third, third-party contribution requirements circumvent the constitutional process for appropriating taxpayer dollars. The Constitution and federal law speak to how federal money can be disbursed, and the teaching of those authorities is that it is Congress's prerogative to decide who should receive taxpayers' dollars. The Constitution bars the government from spending unappropriated funds[24] and the Anti-Deficiency Act[25] prohibits the government from "mak[ing] or authoriz[ing] an expenditure or obligation exceeding . . . an appropriation" or relevant fund.[26] Those provisions are not merely hyper-technical accounting requirements. On the contrary, they reflect a basic allocation of federal decisionmaking authority regarding the proper expenditure of the public's tax dollars. Congress does not give the President a lump sum allowance that he can spend as he sees fit. Instead, in the annual appropriations bills Congress specifies in detail exactly who can receive appropriated funds, how much money each one may be paid, and for what purposes that money can be used. Third-party contribution requirements enable the Executive Branch to perform an end run around Congress's paramount role in the federal appropriations process.

Fourth, this practice denies the public the opportunity to know how public funds are spent and to hold elected officials accountable for their choices by enabling Representatives and Senators to shirk their responsibility. The Constitution and federal code ensure that the Executive Branch cannot spend money without the prior approval of Congress, which requires every Member to cast a ballot for the annual appropriations bills. Those provisions ensure that each voter can know what every Member does with the public's tax dollars and can use that information every two or six years to decide whether to "throw the bums out." By letting the Executive Branch make decisions that the Constitution envisions only Congress should make, the members of Congress who allow this practice to continue are simply avoiding their responsibility to take a public position identifying the proper recipients of the electorate's tax dollars in the hope that the voters will not hold accountable Senators and Representatives at the polls for any funding decisions that the public dislikes. Accordingly, third-party contribution requirements allow legislators to escape political responsibility by denying the public valuable information that it needs to make an informed decision at the polls.

To be sure, leaving appropriations decisions to members of Congress hardly guarantees that personal biases will play no role in how public funds are spent. No one is that gullible. But the public has the opportunity to hold Representatives and Senators accountable at the polls for their decisions, an opportunity that they lack whenever career lawyers or political appointees at the Justice Department—to say nothing of private parties—decide which organizations will benefit from an N/DPA or settlement. The public deserves the opportunity to hold the government

[23] 42 U.S.C. §§ 10601(d)(2), (3), (4) & (5).

[24] *See* U.S. CONST. art. I, § 9, cl. 7 ("No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law . . . .").

[25] Pub. L. No. 97-258, 96 Stat. 923 (1982) (codified at 31 U.S.C. § 1341 (2006)).

[26] 31 U.S.C. § 1341(a)(1)(A) (2006).

accountable for its taxing and spending decisions. Returning that decision to Congress whenever the Justice Department uses such an agreement would be a big step in the right direction.

Fifth, third-party contribution requirements are rife with opportunities for political cronyism. They allow the Justice Department to pick-and-choose among private organizations as to which ones will receive federal funds without any guidance from Congress or any oversight by the Judiciary or Appropriations Committees in each chamber. The entirely discretionary nature of this process can easily lead to favoring one charity or organization over another on entirely subjective grounds. The parties who benefit from the government's disbursement of N/DPA funds may be organizations who should receive federal funds because they improve the lot of the citizenry in various ways. But why should a housing rights organization, for example, receive money that could just as easily go to a school that trains dogs to serve as companions to the blind and as the interface between them and the world? There is no guarantee that the payments a corporation makes to a third-party that it selects or that is chosen by the government will go to the actual victims of a housing fraud scheme, while the payments made to an organization that trains seeing-eye dogs will doubtless directly benefit people obviously less fortunate than most. A reasonable argument can be made that any number of other charitable organizations equally deserves the same opportunity to assist people in need of better food, drinking water, health care, education, access to public transportation, housing, and so forth.

The decision how to disburse federal funds, and whether any of those funds should be given directly to private organizations, should not be made through a process that shrouds how those decisions are made and permits individual decisionmakers to rely on personal biases and predilections. The Justice Department's actions may or may not be defensible under the law, but they certainly do not give the appearance of having been made in a just manner or ensuring a just result. The Justice Department's N/DPA and settlement practices justify the inference that the federal government is extorting settlements from businesses in order to transfer funds to cronies that the Administration could never persuade Congress to appropriate for them.[27]

* * * * *

When deciding whether third-party payment requirements are a sound public policy, it is worthwhile to perform this exercise: Flip the facts of these settlements on their head. Assume that Bank of America and Citigroup settled a lawsuit with the government and would *receive* money to settle the case. Then, ask yourself this question: May the CEO of either bank tell the government to pay millions of dollars to the CEO's or the Department's favorite charity instead of making the check out to Bank of America and Citigroup? No, he may not. That would be a violation of the CEO's fiduciary duty to his company and would be tantamount to theft. In all likelihood, the Justice Department would even take that position. If so, if a corporate CEO cannot give away money that the corporation receives in a settlement agreement, then the Department should not be able to give away funds that it receives in a plea or settlement agreement.

[27] It should be noted that lawyers in Democratic and Republican Administrations have been equally guilty of following this practice. For example, during the George W. Bush Administration, the United States Attorney's Office for the District of New Jersey, which was then headed by Chris Christie, negotiated a nonprosecution agreement with Bristol-Myers Squibb in which the company agreed, among other things, to make a $5 million gift to Seton Hall University's law school—Christie's alma mater—in order to avoid prosecution for securities fraud.

The rules that apply to private parties should also apply to the government. Sauce for the goose should be sauce for the gander.[28]

IV. THE THIRD-PARTY PAYMENT REQUIREMENTS IN THE HOUSING SETTLEMENT CASES ARE EXAMPLES OF THE PROBLEMS THESE CONDITIONS POSE

The housing settlements were controversial when inked because there was a decided ideology to many of the groups who have benefitted from the Justice Department's largesse. According to Investor's Business Daily, "[r]adical Democrat activist groups stand to collect millions from Attorney General Eric Holder's record $17 billion deal to settle alleged mortgage abuse charges against Bank of America. [¶] Buried in the fine print of the deal, which includes $7 billion in soft-dollar consumer relief, are a raft of political payoffs to Obama constituency groups. In effect, the government has ordered the nation's largest bank to create a massive slush fund for Democrat special interests."[29] Investor's Business Daily offered the following examples:

> According to the list provided by Justice, [housing activist groups approved by HUD] include some of the most radical bank shakedown organizations in the country, including:
>
> • La Raza, which pressures banks to expand their credit box to qualify more low-income Latino immigrants for home loans;
>
> • National Community Reinvestment Coalition, Washington's most aggressive lobbyist for the disastrous Community Reinvestment Act;
>
> • Neighborhood Assistance Corporation of America, whose director calls himself a "bank terrorist;"
>
> • Operation Hope, a South Central Los Angeles group that's pressuring banks to make "dignity mortgages" for deadbeats.
>
> Worse, one group eligible for BofA slush funds is a spin-off of Acorn Housing's branch in New York. [¶] It's now rebranded as Mutual Housing Association of New York, or MHANY. HUD lists MHANY's contact as Ismene Speliotis, who previously served as New York director of Acorn Housing.[30]

That is not all. The settlement stipulates that any money remaining after four years should be disposed of as follows:

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[28] *See* Paul J. Larkin, Jr., Public *Choice Theory and Overcriminalization*, 36 HARV. J.L. & PUB. POL'Y 715, 786-90 (2013).

[29] Editorial, "Holder Cut Left-Wing Groups In on $17 Bill BofA Deal," Investor's Business Daily, IBD.com, Aug. 27, 2014, http://news.investors.com/ibd-editorials/082714-715046-holders-bank-of-america-settlement-includes-payoffs-to-democrat-groups.htm?p=full. The settlement agreement with Bank of America resolves one pending case and numerous other investigations that the Justice Department has pursued into alleged mortgage fraud that have not resulted in criminal charges or civil complaints. *See* Bank of America Settlement Agreement (signed Aug. 18-20, 2014), http://www.justice.gov/iso/opa/resources/9622014821111642417595.pdf.

[30] *Id.*

If there are leftover funds in four years, the settlement stipulates the money will go to Interest on Lawyers' Trust Account (IOLTA), which provides legal aid for the poor and supports left-wing causes, and NeighborWorks of America, which provides affordable housing and funds a national network of left-wing community organizers operating in the mold of Acorn.

In fact, in 2008 and 2009, NeighborWorks awarded a whopping $25 million to Acorn Housing.

In 2011 alone, NeighborWorks shelled out $35 million in "affordable housing grants" to 115 such groups, according to its website. Recipients included the radical Affordable Housing Alliance, which pressures banks to make high-risk loans in low-income neighborhoods and which happens to be the former employer of HUD's chief "fair housing" enforcer.[31]

The Justice Department acknowledges that the settlement agreements require that "donations" be paid to third parties.[32] The Department also appears to confess that those third parties are not victims of the banks' wrongdoing. As the Department noted in its January 6, 2015, letter to Chairmen Goodlatte and Hensarling, "the consumer relief provisions in the Bank of America and Citigroup settlements" require those banks to make "donations to certain categories of community development funds, legal aid organizations, and housing counseling agencies[.]"[33] The Department, however, does not identify any express statutory authority to disburse federal funds to private parties. Instead, the government defends those requirements on the ground that they are reasonable because the amount at issue is "a much smaller commitment" than what the banks must pay to the federal government, because the "donations are calibrated to provide assistance to those consumers and communities most in need of help," and because "the banks are responsible for choosing specific recipients of consumer relief funds."[34] Those defenses are unpersuasive, however, for several reasons

First, no policy argument can substitute for statutory authority. If the government does not need statutory authority to disburse to private parties a "small[]" portion of the money that it receives in a settlement, then it may disburse a "larger" portion of those receipts. Indeed, under the government's theory it could give third parties the entire *$8.2 billion check* that is to be paid to the Department of Justice.[35] The Department's argument that its action is reasonable in fact stands as a powerful argument for requiring the government to have statutory authority to give away money that otherwise would be paid into the federal treasury. Otherwise, there is no nonarbitrary way to draw a line between a "reasonable" and an "unreasonable" give-away of money that belongs to the public.

Second, federal law seeks to ensure that the victims of crime receive some compensation for the losses that they have suffered due to the crimes for which a defendant stands convicted.

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[31] *Id.*

[32] *See* Letter from Peter J. Kadzik, Ass't Att'y Gen'l, to Bob Goodlatte, Chairman, H. Comm. on the Judiciary, & Jeb Hensarling, Chairman, H. Comm. on Financial Servs. 1-3 (Jan. 6, 2015).

[33] *Id.* at 2-3.

[34] *Id.* at 1-2.

[35] *Id.* at 5.

Here, however, there was no conviction, and no judicial finding that the private recipients were "victims" of a crime. Even the government does not claim that all of the recipients are victims of the banks' unlawful conduct. The government only says that the recipients are "those consumers and communities most in need of help." Deciding which consumers and communities need financial help is inherently a legislative function. Under Article I of the Constitution, Congress, not the Executive Branch, has the prerogative to create the "law" establishing a financial assistance program and defining the eligibility requirements. If Congress believes that the taxpayers should fund some third-party organizations, then Congress can appropriate federal money for that purpose.

Third, it is immaterial that the Justice Department has delegated to the settling banks the ability to select the particular recipients of their donations. The banks have agreed to settle the claims in lieu of defending themselves at trial and to pay money for that privilege. It is the Justice Department's authority that is at issue, not the banks'. The Department's decision to permit the banks to name the payees does not change the fact that the Department is permitting the banks to give away funds that otherwise would be deposited into the treasury. If the Department could not write those third parties a check after the money had been paid into the treasury, the Department should not be able to enter into an agreement with the banks that has the same effect. Any mature system of law treats a sham transaction as null and void. That characterization is applicable here.

Perhaps these problems could be overlooked if the amounts at issue here were trivial, if what we were concerned with was tantamount to a proverbial cup of coffee. But the amounts involved here are considerable. The agreements contemplate that the banks may potentially pay millions to various private organizations. Taxpayers would not find that amount of money trivial.

V. Potential Remedies For These Problems

The best remedy for this problem is to deny the Justice Department the opportunity to make any discretionary disbursement decisions. Congress could by statute require that any and all funds paid by an individual or a corporation in connection with a plea bargain, a N/DPA, or settlement of any type must be deposited into the federal treasury, where they will be paid out as part of the ordinary appropriations process. The Executive Branch can always encourage Congress to fund particular organizations with the money received through a deferred or nonprosecution agreement, even if it wishes that money to be paid to a friend, but that approach will force the executive to make its cronyism clear and will force each Member of the House and Senate to state publicly whether to endorse or reject the administration's request in the same way that those chambers make all other appropriations decisions. That approach will return the disbursement process to its rightful place in government and will help educate the public about how its tax dollars are spent.

Another remedy, which can be required in addition to the one mentioned above, is to enlist the aid of Federal Magistrate Judges to review these settlements to ensure that any third-party payments go only to actual victims of any alleged wrongdoing. At present, this process is largely left to the parties to negotiate a workable agreement without any serious judicial oversight in the case of a deferred prosecution agreement or any supervision at all when a nonprosecution agreement is used. In the case of a deferred prosecution agreement, the government already has filed

a charge in federal court, so a district court judge must approve the government's decision to dismiss an indictment or information. Judicial review, however, is quite limited in that setting.[36]

For all practical purposes, as long as the government has not sought to dismiss the prosecution for an illegitimate reason—for instance, the prosecutor was bribed to "deep six" the case—the district court must go along with the government's request.[37] By contrast, whenever the government seeks to enter into a nonprosecution agreement, no charges have been or will be filed, so no district court judge may be able to review the agreement's terms.[38] Given the Article III "Case or Controversy" requirement, it may not be possible to enlist a federal district court to review such an agreement.[39] Congress could entrust that responsibility, however, to a Magistrate Judge, who is not an Article III officer.[40] This proposal ensures that a second, neutral pair of eyes reviews every nonprosecution agreement and ensures that only the victims of any possible crimes benefit from any N/DPA third-party payments.

Finally, Congress could decide to deduct from the Justice Department appropriations an amount equal to any money that has already been disbursed and cannot be recovered.

CONCLUSION

Plea agreements and settlements are often used to resolve corporate criminal and civil cases. N/DPAs are increasingly becoming another alternative to trial. All three dispositions may contain third-party payment requirements. Those requirements raise several important public policy issues, however, and deserve to be subjected to Congressional oversight and regulation. The practice of forcing a corporation to make contributions to third parties designated in any such agreement enables Justice Department lawyers to disburse to third parties of their own choosing, or perhaps of the defendant's, money that properly should be paid into the federal treasury. Only elected federal officials should make appropriations decisions. Congress should prohibit this practice altogether, and it should require that a Magistrate Judge review the appropriateness of every agreement in order to ensure that government lawyers use this disbursement authority only to compensate proven victims of criminal wrongdoing, not the Administration's cronies.

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[36] *See* Fed. R. Crim. P. 48(a) ("The government may, with leave of court, dismiss an indictment, information, or complaint. The government may not dismiss the prosecution during trial without the defendant's consent.").

[37] *See supra* note 3.

[38] Federal judges can be tasked with the performance of duties other than adjudicating cases and controversies. *See, e.g.*, Mistretta v. United States, 488 U.S. 361, 384-408 (1989) (Article III judges can voluntarily serve as members of the U.S. Sentencing Commission). The Supreme Court, however, may find that supervising the administration of N/DPAs too closely resembles the process of supervising the parties' duties under a consent decree for an Article III judge to undertake that task.

[39] *See, e.g.*, Hayburn's Case, 2 U.S. (2 Dall.) 409 (1792) (Article III courts cannot issue advisory opinions).

[40] *Compare, e.g.*, U.S. CONST. art. III, § 1 (Article III judges serve during "good Behaviour"), *with* Federal Magistrate's Act, 28 U.S.C. § 631 (2012) (full-time magistrates serve an eight-year term; part-time magistrates, a four-year term).

APPENDIX A

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APPENDIX B

42 U.S.C.A. § 10601

§ 10601. Crime Victims Fund

(a) Establishment

There is created in the Treasury a separate account to be known as the Crime Victims Fund (hereinafter in this chapter referred to as the "Fund").

(b) Fines deposited in Fund; penalties; forfeited appearance bonds

Except as limited by subsection (c) of this section, there shall be deposited in the Fund--

(1) all fines that are collected from persons convicted of offenses against the United States except--

(A) fines available for use by the Secretary of the Treasury pursuant to--

(i) section 11(d) of the Endangered Species Act (16 U.S.C. 1540(d)); and

(ii) section 6(d) of the Lacey Act Amendments of 1981 (16 U.S.C. 3375(d)); and

(B) fines to be paid into--

(i) the railroad unemployment insurance account pursuant to the Railroad Unemployment Insurance Act (45 U.S.C. 351 et seq.);

(ii) the Postal Service Fund pursuant to sections 2601(a)(2) and 2003 of Title 39 and for the purposes set forth in section 404(a)(7) of Title 39;

(iii) the navigable waters revolving fund pursuant to section 311 of the Federal Water Pollution Control Act (33 U.S.C. 1321); and

(iv) county public school funds pursuant to section 3613 of Title 18;

(2) penalty assessments collected under section 3013 of Title 18;

(3) the proceeds of forfeited appearance bonds, bail bonds, and collateral collected under section 3146 of Title 18;

(4) any money ordered to be paid into the Fund under section 3671(c)(2) of Title 18; and

(5) any gifts, bequests, or donations to the Fund from private entities or individuals, which the Director is hereby authorized to accept for deposit into the Fund, except that the Director is not hereby authorized to accept any such gift, bequest, or donation that--

(A) attaches conditions inconsistent with applicable laws or regulations; or

(B) is conditioned upon or would require the expenditure of appropriated funds that are not available to the Office for Victims of Crime.

(c) Retention of sums in Fund; availability for expenditure without fiscal year limitation

Sums deposited in the Fund shall remain in the Fund and be available for expenditure under this chapter for grants under this chapter without fiscal year limitation. Notwithstanding subsection (d)(5) of this section, all sums deposited in the Fund in any fiscal year that are not made

available for obligation by Congress in the subsequent fiscal year shall remain in the Fund for obligation in future fiscal years, without fiscal year limitation.

(d) Availability for judicial branch administrative costs; grant program percentages

The Fund shall be available as follows:

(1) Repealed. Pub. L. 105-119, Title I, § 109(a)(1), Nov. 26, 1997, 111 Stat. 2457

(2)(A) Except as provided in subparagraph (B), the first $10,000,000 deposited in the Fund shall be available for grants under section 10603a of this title.

(B)(i) For any fiscal year for which the amount deposited in the Fund is greater than the amount deposited in the Fund for fiscal year 1998, the $10,000,000 referred to in subparagraph (A) plus an amount equal to 50 percent of the increase in the amount from fiscal year 1998 shall be available for grants under section 10603a of this title.

(ii) Amounts available under this subparagraph for any fiscal year shall not exceed $20,000,000.

(3)(A) Of the sums remaining in the Fund in any particular fiscal year after compliance with paragraph (2), such sums as may be necessary shall be available only for--

(i) the United States Attorneys Offices and the Federal Bureau of Investigation to provide and improve services for the benefit of crime victims in the Federal criminal justice system (as described in 3771 of title 18[1] and section 10607 of this title) through victim coordinators, victims' specialists, and advocates, including for the administrative support of victim coordinators and advocates providing such services; and

(ii) a Victim Notification System.

(B) Amounts made available under subparagraph (A) may not be used for any purpose that is not specified in clause (i) or (ii) of subparagraph (A).

(4) Of the remaining amount to be distributed from the Fund in a particular fiscal year--

(A) 47.5 percent shall be available for grants under section 10602 of this title;

(B) 47.5 percent shall be available for grants under section 10603(a) of this title; and

(C) 5 percent shall be available for grants under section 10603(c) of this title.

(5)(A) In addition to the amounts distributed under paragraphs (2), (3), and (4), the Director may set aside up to $50,000,000 from the amounts transferred to the Fund in response to the airplane hijackings and terrorist acts that occurred on September 11, 2001, as an antiterrorism emergency reserve. The Director may replenish any amounts obligated from such reserve in subsequent fiscal years by setting aside up to 5 percent of the amounts remaining in the Fund in any fiscal year after distributing amounts under paragraphs (2), (3) and (4). Such reserve shall not exceed $50,000,000.

(B) The antiterrorism emergency reserve referred to in subparagraph (A) may be used for supplemental grants under section 10603b of this title and to provide compensation to victims of international terrorism under section 10603c of this title.

(C) Amounts in the antiterrorism emergency reserve established pursuant to subparagraph (A) may be carried over from fiscal year to fiscal year. Notwithstanding subsection (c) of this

section and section 619 of the Departments of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, 2001 (and any similar limitation on Fund obligations in any future Act, unless the same should expressly refer to this section), any such amounts carried over shall not be subject to any limitation on obligations from amounts deposited to or available in the Fund.

(e) Amounts awarded and unspent

Any amount awarded as part of a grant under this chapter that remains unspent at the end of a fiscal year in which the grant is made may be expended for the purpose for which the grant is made at any time during the 3 succeeding fiscal years, at the end of which period, any remaining unobligated sums shall be available for deposit into the emergency reserve fund referred to in subsection (d)(5) of this section at the discretion of the Director. Any remaining unobligated sums shall be returned to the Fund.

(f) "Offenses against the United States" as excluding

As used in this section, the term "offenses against the United States" does not include--

(1) a criminal violation of the Uniform Code of Military Justice (10 U.S.C. 801 et seq.);

(2) an offense against the laws of the District of Columbia; and

(3) an offense triable by an Indian tribal court or Court of Indian Offenses.

(g) Grants for Indian tribes; child abuse cases

(1) The Attorney General shall use 15 percent of the funds available under subsection (d)(2) of this section to make grants for the purpose of assisting Native American Indian tribes in developing, establishing, and operating programs designed to improve--

(A) the handling of child abuse cases, particularly cases of child sexual abuse, in a manner which limits additional trauma to the child victim; and

(B) the investigation and prosecution of cases of child abuse, particularly child sexual abuse.

(2) The Attorney General may use 5 percent of the funds available under subsection (d)(2) of this section (prior to distribution) for grants to Indian tribes to establish child victim assistance programs, as appropriate.

(3) As used in this subsection, the term "tribe"[2] has the meaning given that term in section 450b(b) of Title 25.

Mr. MARINO. Thank you, sir.
Mr. Frank?

TESTIMONY OF THEODORE H. FRANK, FOUNDER, CENTER FOR CLASS ACTION FAIRNESS, WASHINGTON, DC

Mr. FRANK. Thank you, Mr. Chairman, Mr. Ranking Member——

Mr. MARINO. You want to push that button.

Mr. FRANK. Thank you, Mr. Chairman, Mr. Ranking Member, and the Committee for having me here. I am the head of the nonprofit public interest law firm, Center for Class Action Fairness, but I do not speak on their behalf today. However, my experience with the center is with civil litigation in class action settlements that raise very similar issues where class counsel breached their fiduciary duty to their clients and tried to divert money to third party charities rather than to the purportedly injured plaintiffs in a class action.

So, for example, 5 weeks ago we won a case in the 8th Circuit involving Bank of America shareholders where class counsel for the shareholders, instead of distributing $2.7 million of leftover money to the shareholders, decided that he wanted to write a big check to the local Legal Aid Society and have a ceremony of the big check where he would get his picture in the paper. That might be nice for the attorney who has more gratitude from his local charity than from shareholders getting a few dollars each, but it is a breach of their fiduciary duty, and we got that diversion overturned.

We won another case in the 9th Circuit, *Nachshin v. AOK*, where the lawyers tried to give money to the judge's husband's charity. These are real conflicts of interest. They are real problems, and courts have been stepping in. Most notably, Chief Justice Roberts indicated the need for this in the *Merrick v. Lane* case, 134 S. Ct., page 8.

The problem is even more egregious in the prosecution context for the reasons Mr. Larkin has just demonstrated, but I would like to raise some other issues. These settlements are being discussed as providing $7 billion of consumer relief or $2.5 billion of consumer relief. But when you get into the weeds of the agreements in Annex Number 2, you see these $2 or $1 credits, $3 credits, as much as $3.75 per dollar credits. And as a result, you are not talking about a diversion of $150 million. You are talking about the Department of Justice getting credit for "$7 billion of consumer relief," but, in fact, the banks will be paying billions of dollars less in order to funnel money to the Department of Justice's preferred recipients.

Now, again, as Mr. Larkin said, it may be some of these recipients are good. They may not be. But at the end of the day, the Justice Department does not have the authority to do that except by bypassing the Treasury through these settlement agreements, and the bypassing has other legal consequences. For example, in Chapter 45 of the Code of Federal Regulations, when the Federal Government gives money to legal aid societies, as this settlement requires, there are a lot of strings attached to that Federal money. The legal aid societies can only use it in certain ways.

This settlement bypasses those congressional restrictions or these Federal legal regulations and restrictions. And, again, the

monitor will not be overseeing this. The monitor is only determining whether the bank has given the money that they are supposed to give.

Other problems. In effect, DOJ is creating housing policy, Treasury policy, and in many ways, overriding existing policies of the Treasury Department and the Housing Department without any oversight from Congress or otherwise. So there is credit being given for loan modifications that do not satisfy the Treasury Department's HAMP requirements. Now, there are disputes over whether or not HAMP is effective, but what is clear is if you loosen those requirements, it is going to be less effective than the existing Treasury Department program. But the DOJ is now creating its own loan modification program without the regulatory expertise to do so, and with potentially adverse public policy results.

There is another provision in the Bank of America settlements in Section 2.A of the Annex, menu item 2.A of the Annex. Bank of America gets a $10,000 credit for providing first-time home buyers of lower/moderate income a loan. Now, there are two possibilities there. One, these are financially viable loans that Bank of America would be happy to make anyway, in which case it is completely illusory relief. They are just going to get a $10,000 offset to what is supposed to be consumer relief. Or these are not financially viable loans, but the DOJ is distorting the market for loans to encourage yet more loans for mortgages that potential low and moderate income people cannot actually afford. And that is how we got into this mess in the first place.

I welcome your questions.

[The prepared statement of Mr. Frank follows:]

Statement before the House Judiciary Committee
Subcommittee on Regulatory Reform, Commercial and Antitrust Law

Oversight of the Justice Department's Mortgage Lending Settlements

Theodore H. Frank

CCAF
Center for Class Action Fairness

February 12, 2015

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the Center for Class Action Fairness.

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Thank you, Mr. Chairman, and members of this Subcommittee, for your kind invitation to testify today about the Justice Department mortgage lending settlements.

I serve as President for the Center for Class Action Fairness,[1] but I am not testifying here on their behalf and the views that I am sharing today are my own. My perspective comes from my legal practice running a non-profit public-interest law firm focusing on litigation in class actions on behalf of class members in cases where their court-appointed attorneys have failed to fairly represent their clients' interests by structuring settlements to have defendants pay money to third-party organizations rather than to the alleged victims of their conduct—a practice often justified under the misnomer "*cy pres*." I was elected to the American Law Institute in 2008, and have published and spoken across the country on topics related to class action settlements and *cy pres*.[2]

Private class action settlements are problematic because of the inherent conflict of interest between class counsel and their putative clients. Public enforcement would normally avoid these problems, but when public enforcers are permitted to use

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[1] I founded the Center for Class Action Fairness in 2009. The Center is a 501(c)(3) non-profit public-interest law firm that represents *pro bono* consumers and shareholders objecting to unfair class action settlements that benefit class counsel at the expense of their putative clients. Attorneys with the Center have won several landmark cases expanding the rights of consumers in class action settlements and tens of millions of dollars for consumers and shareholders. *E.g.*, *Oetting v. Green Jacobson, P.C.*, No. 13-2620 (8th Cir. 2015); *Pearson v. NBTY, Inc.*, 772 F.3d 778 (7th Cir. 2014); *In re Baby Products Antitrust Litigation*, 708 F.3d 163 (3d Cir. 2013); *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2011); *In re Bluetooth Prod. Liab. Lit.*, 654 F.3d 935 (9th Cir. 2011).

[2] Portions of this testimony are drawn from Theodore H. Frank, Statement before the House Judiciary Committee Subcommittee on the Constitution and Civil Justice, *Examination of Litigation Abuse* (Mar. 13, 2013); Ted Frank, *Class Actions, Arbitration, and Consumer Rights*, Legal Policy Report No. 16 (Manhattan Institute 2013); Theodore H. Frank, *Cy Pres Settlements*, Class Action Watch (Mar. 2008).

settlements to structure public policy or divert settlement money to third parties, it reintroduces the conflict-of-interest problem into the mix.

The Justice Department settlement with Bank of America presents a particularly problematic application of *cy pres*. When the Justice Department negotiates settlements that send money to third parties instead of to the United States Treasury or to the primary victims of the challenged conduct without legislative authority, they violate separation of powers by effectively using executive-branch enforcement authority to create legislative spending power. The spending may evade laws and regulations limiting or controlling federal spending, or create or fund programs that Congress never would have agreed to spend. The settlement further meddles in public policy in counterproductive and unfair ways that will ultimately result in making many consumers worse off.

Background: Private Class Action Settlements and the Problem of *Cy Pres* Relief

Class actions were designed to provide injured parties with a more efficient means of accessing justice by aggregating claims for violations of individual rights.[3] Although most successful class action litigation under Rule 23 is resolved in the form of a class settlement, such class settlements frequently provide little or no meaningful compensation to consumers. Indeed, a significant number of consumer class settlements do not provide consumers with any monetary relief whatsoever. This systematic under-compensation is the product of two structural problems in class actions. First, because class attorneys' fees generally come from the same source as the class members' compensation—the defendant—class attorneys settling class claims have a fundamental conflict of interest.[4] Second, to the extent class attorneys exploit that conflict of interest, judges lack the necessary information or incentive to rectify self-dealing in most cases.

The principal reason for the failure of many class settlements to provide meaningful compensation is obvious: class attorneys have incentives to engage in self-dealing during the negotiation of class settlements.[5] Because class members, especially

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[3] *See* Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. Chi. Legal F. 71, 77 (2003).

[4] *E.g., Pearson, supra*; *Redman v. RadioShack Corp.*, 768 F.3d 622 (7th Cir. 2014); *Eubank v. Pella Corp.*, 753 F.3d 718 (7th Cir. 2014).

[5] *See, e.g.,* Ted Frank, *Class Actions, Arbitration, and Consumer Rights*, Legal Policy Report No. 16 at 6-11 (Manhattan Institute 2013); Lester Brickman, *Lawyer Barons* 335-72 (Cambridge U. Press 2011); John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort*

those in a small-claims consumer class action, have small stakes in the case and therefore usually do not closely monitor their attorneys' conduct, class attorneys often are able to obtain high fees without obtaining meaningful compensation for class members.[6]

Indeed, all three branches of government have recognized this economic reality. In enacting the Class Action Fairness Act of 2005,[7] Congress found that "[c]lass members often receive little or no benefit from class actions, and are sometimes harmed, such as where . . . counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value."[8]

Similarly the FTC has recognized that "[e]xcessive class action attorney fee awards represent a substantial source of consumer harm."[9]

Class Action, 95 Colum. L. Rev. 1343, 1347-48 (1995); Coffee, 54 U. Chi. L. Rev. at 883-84; Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 7-8 (1991).

[6] In a now-classic study, Andrew Rosenfeld demonstrated that a class attorney that settles a class action enjoys a "settlement premium" above the average attorney's fee awarded in a class action that proceeds to judgment. *See An Empirical Test of Class-Action Settlement*, 5 J. Legal Stud. 113, 115-17 (1976). This premium is consistent with the hypothesis that class attorneys will maximize their fees at the expense of the class members' compensation. *See also, e.g.*, Frank, *Class Actions* 6-11; Coffee, 54 U. Chi. L. Rev. at 883-84.

[7] CAFA, Pub. L. No. 109-2, § 2, 119 Stat. 4.

[8] *See id.* at 4; *see also* S. Rep. No. 109-4, at 33.

[9] R. Ted Cruz, Dir. Office of Policy Planning, FTC, Friend of the Court: The Federal Trade Commission's Amicus Program, Remarks Before the Antitrust Section of the American Bar Association 13 (Dec. 12, 2002) ("Not infrequently, the interests of a private class action attorney may substantially diverge from the interests of the class."), *available at* http://ftc.gov.speeches/other/tcamicus; Deborah Platt Majoras, Chairwoman, FTC, *Comments at the FTC Workshop: Protecting Consumer Interests in Class Actions* (Sept. 13, 2004), *in* 18 Geo. J. Legal Ethics 1161, 1162-63 (2005) (class actions may not "truly serve consumers' interests by providing them appropriate benefits"; encouraging "consumers to carefully scrutinize opt-out notices and class action settlement terms and

Courts also have recognized the harm to consumer welfare caused by the class attorney's conflict of interest: "the negotiator on the plaintiffs' side, that is, the lawyer for the class, is potentially an unreliable agent of his principals" given the possibility that he may trade a small class award for the relatively certainty of a high fee award.[10]

One of the leading ways for self-dealing class counsel to benefit themselves at the expense of the class is through what are called *cy pres* settlements.

The idea of *cy pres* (pronounced "see pray" or "sigh pray," from the French *cy pres comme possible*—"as near as possible") originated in the trust context, where courts would reinterpret the terms of a charitable trust when literal application of those terms resulted in the dissolution of the trust because of impossibility or illegality.[11] In a classic 19th-century example, a court repurposed a trust that had been created to abolish slavery in the United States to instead provide charity to poor African-Americans.[12] The California Supreme Court endorsed the use of *cy pres* or "fluid recovery" mechanism in class action settlements in 1986, to distribute proceeds to a "next best" class of

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particularly attorney fee awards that may reduce the total compensation available to consumers").

[10] *Mars Steel Corp. v. Continental Ill. Nat'l Bank & Trust Co.*, 834 F.2d 677, 681-82 (7th Cir. 1987).

[11] Susan Beth Farmer, *More Lessons From the Laboratories: Cy Pres Distributions in Parens Patriae Antitrust Actions Brought by State Attorneys General*, 68 FORDHAM L. REV. 361, 391-93 (1999); RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 509-10 (4th ed. 1992); BRYAN A. GARNER, BLACK'S LAW DICTIONARY 392 (7th ed. 1999). "Justification for the use of the doctrine [in the middle ages] was laid on the shoulders of the donor, the idea being since the object of the testator in donating the money to charity was to obtain an advantageous position in the kingdom of heaven, he ought not to be frustrated in this desire because of an unexpected or unforeseen failure." *Id.* (quoting EDITH L. FISCH, THE CY PRES DOCTRINE IN THE UNITED STATES 4 (1950)). For more on *cy pres*, *see* Frank, *Class Actions* 8-9; Martin Redish *et al.*, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617 (2010); John H. Beisner *et al.*, *Cy Pres: A Not So Charitable Contribution to Class Action Practice* (2010); Theodore H. Frank, *Cy Pres Settlements*, Class Action Watch (Mar. 2008).

[12] *Jackson v. Phillips*, 96 Mass. 539 (1867). *But see* Evans v. Abney, 396 U.S. 435 (1970) (upholding Georgia Supreme Court's dissolution of trust providing for segregated municipal park).

consumers, and many other courts have gradually adopted the procedure.[13] *Cy pres* settlements arise in one of three circumstances:

- There is a fixed settlement fund that exceeds the amount paid out because only a few class members have registered to be claimants;
- The court (often at the parties' behest) decides that administering a settlement by paying class members directly would be too expensive;
- The parties otherwise agree that a case shall be settled by paying a third party.

While original *cy pres* class action settlements provided that left-over money be distributed to a different set of consumers who may or may not coincide with the class, in recent years, left-over, or specifically earmarked, funds are typically given directly to a third-party charity.

The problem with *cy pres* is that it exacerbates existing conflicts of interest in the class action settlement context. When a class attorney settles a class action, he or she is not only negotiating class recovery, but is also negotiating his or her own fee. A defendant may be willing to spend a certain amount of money to settle a class action to avoid the expense and risk of litigation, but that money must be divided between the class and their attorneys. Every dollar going to the attorneys does not go to the class, and vice versa. At the same time, a class action settlement must be approved by the court. Attorneys who do not adhere to their fiduciary responsibility to the class have an incentive to exaggerate class recovery to a court to maximize their fees.

The possibility of *cy pres* awards gives an additional incentive to class action attorneys to breach their fiduciary duties to the class. Every dollar that a class member does not recover can now be spent by the attorney himself to the charity of the attorney's choice. Attorneys essentially get free advertising: witness the existence of websites like "ohiolawyersgiveback.com" where lawyers are using their clients' money to advertise themselves. At best this is unseemly; at worst, it is an unethical breach of the attorneys' fiduciary duty to put the interests of their clients first. If courts permit unfettered *cy pres*, then attorneys have an incentive to make it difficult for their own putative clients to recover, because then they can maximize the amount of money that goes to charity in the attorneys' names. This hurts class members. For example, in a settlement I successfully challenged in the Third Circuit,[14] the parties created substantial burdens, including a five-page claim form with confusing instructions, that successfully

[13] *State v. Levi Strauss & Co.*, 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (1986).

[14] *Baby Products, supra.*

deterred class members from making claims on the settlement fund. If my client had not successfully appealed the settlement approval, class members would have received less than $3 million, while the class counsel would have received about $15 million to distribute to its favorite charity, plus another $14 million for itself.

Judge Richard Posner has argued that *cy pres* is a misnomer in the class action context:

> [*Cy pres*] doctrine is based on the idea that the settlor would have preferred a modest alteration in the terms of the trust to having the corpus revert to his residuary legatees. So there is an indirect benefit to the settlor. In the class action context the reason for appealing to cy pres is to prevent the defendant from walking away from the litigation scot-free because of the infeasibility of distributing the proceeds of the settlement (or the judgment, in the rare case in which a class action goes to judgment) to the class members. There is no indirect benefit to the class from the defendant's giving the money to someone else. In such a case the "cy pres" remedy (badly misnamed, but the alternative term—"fluid recovery"—is no less misleading) is purely punitive.[15]

But sometimes *cy pres* is less a matter of being punitive and more a matter of disguising the true cost of a settlement to the defendant to maximize the share of the actual recovery received by the plaintiffs' attorneys. If the beneficiary is related to the defendant, or the defendant otherwise benefits from the payout, then the contingent attorneys' fee can be exaggerated by claiming that the value to the class is equal to nominal value of the payment to the beneficiary; the defendant is willing to make a larger nominal contribution to settle the case than the actual cost to the defendant. For example, a California state court settlement of a derivative action against Larry Ellison alleging insider trading settled when Ellison agreed to pay $100 million to a charity chosen by Oracle—even though the billionaire has previously stated that his fortune would go to charity.[16] The only real expense to Ellison was the $22 million attorneys'

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[15] *Mirfahisi v. Fleet Mortgage Corp.*, 356 F.3d 781, 784 (7th Cir. 2004).

[16] Ted Frank, "Final update: Oracle settlement," Point of Law weblog, http://www.pointoflaw.com/archives/001875.php (Nov. 23, 2005) ("That the plaintiffs are settling for pennies on the dollar with no benefit to the corporation on whose behalf they're ostensibly suing, as well as the fact that a Delaware court has already absolved Ellison of the same charges, suggests that even the plaintiffs recognize the suit as meritless."); Michael Paige, "Judge OKs Ellison's $122M settlement," MarketWatch, Nov. 22, 2005; Peter Branton, "Wealth of Experience," IT Weekly (Jul. 9, 2006) ("I think

fee. More recently, Facebook settled a suit by establishing a charity run by a Facebook board member, and funding it with $6.5 million dollars; again, the class did not benefit, and the only expense to Facebook was the $2 million fee paid to the class attorneys.[17] If the charitable contribution is one that the defendant was making anyway, the effect on the defendant is one of a change of accounting entries rather than any cost to the defendant or benefit to the class aside from the attorneys' fees.[18] While federal courts are starting to crack down on such abuses, they are doing so inconsistently, and parties are still trying to get away with such shenanigans.[19]

Further ethical problems arise if the beneficiary is related to the judge. The *New York Times* has documented the problem of charities soliciting judges for leftover settlement money.[20] In one notorious case, a judge directed *cy pres* to an animal-rights group in a class action over a hotel fire.[21] In a mass-tort inventory settlement of fen-phen cases in Kentucky, tens of millions of dollars intended for plaintiffs was diverted to a newly created charity, where the judge who approved the settlement and three of

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after a certain amount, I'm going to give almost everything I have to charity because what else can you do with it?").

[17] *Marek v. Lane*, -- U.S. --, 134 S.Ct. 8 (2013).

[18] For example, Kellogg agreed to class action settlements that required it to donate a few million dollars of products to food-banks—something it was already doing to the tune of tens of millions of dollars a year. *Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012) (rejecting settlement).

[19] *Compare Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012); *Nachshin v. AOL LLC*, 663 F.3d 1034 (9th Cir. 2011); *and Klier v. Elf Atochem N. Am.*, Inc., 658 F.3d 468 (5th Cir. 2011); *with Lane v. Facebook*, 696 F.3d 811 (9th Cir. 2012), *en banc review denied*, 709 F.3d 791 (9th Cir. 2013), *cert. denied*, *Marek v. Lane*, 134 S.Ct. 8 (2013). In *Lane*, the *cy pres* went to a new charity established by defendant Facebook, who could then direct the money to recipients favorable to Facebook's lobbying interests, a tactic that is being repeated by Facebook in the pending *Fraley v. Facebook* settlement. Adam Liptak, *When Lawyers Cut Their Clients Out of the Deal*, N.Y. TIMES (Aug. 12, 2013); Roger Parloff, *Google and Facebook's new tactic in the tech wars*, CNN MONEY (Jul. 30, 2012), available at http://tech.fortune.cnn.com/2012/07/30/google-and-facebooks-new-tactic-in-the-tech-wars/.

[20] Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES (Nov. 26, 2007).

[21] *In re San Juan Dupont Plaza Hotel Fire Litigation*, 2010 WL 60955 (D. P.R. Jan. 7, 2010).

the plaintiffs' attorneys sat as board members, each receiving tens of thousands of dollars for their service. The settlement also provided a million dollars to the alma mater of one of the trial lawyers, which then hired the attorney for a $100,000/year no-show job. (Two of the attorneys were eventually convicted, and too few people went to prison over this.)[22]

While this is obviously an extreme case, it does illustrate the ethical problems associated with judges choosing or approving charitable destinations for settlement money. In a settlement I objected to, the parties in a nationwide class action proposed a *cy pres* award to a local charity where the judge's husband served as a board member; the judge rubber-stamped the proposed settlement over an objection regarding the appropriateness of the *cy pres* award.[23] The Ninth Circuit reversed on other grounds, but refused to condemn the conflict of interest.[24] This appearance of impropriety damages public perceptions of the fairness of the justice system, and appellate courts should be doing more to police it.

More frequently, if the beneficiary is related to the plaintiffs' attorneys, or the plaintiffs' attorneys otherwise benefit from the payout, the award rewards trial lawyers twice: first by providing *cy pres* recovery to an organization that supports the agenda or causes of the trial lawyers bringing the case, and then a second time by basing attorneys' fees on the first amount.

In July 2007, a district court judge granted a motion to award $5.1 million of unclaimed antitrust settlement funds to George Washington University to create a "Center for Competition Law" on the grounds that it would "benefit the plaintiff class and similarly situated parties by creating a Center that will help protect them from future antitrust violations and violations of other competition laws."[25] The lead plaintiffs' attorney was a GWU Law alumnus.[26] I represent a client whose class counsel

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[22] Ted Frank, "Fen-Phen Zen," American.com (Apr. 4, 2007).

[23] Nathan Koppel, *Proposed Facebook Settlement Comes Under Fire*, WALL STREET JOURNAL (Mar. 2, 2010).

[24] *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2011).

[25] Diamond Chemical Co. v. Akzo Nobel Chemicals B.V., No. 01-2118 (May 14, 2007) ("Diamond I"); Diamond Chemical Co. v. Akzo Nobel Chemicals B.V., No. 01-2118 (Jul. 10, 2007); George Washington University press release, July 11, 2007.

[26] Ashley Roberts, *Law School Gets $5.1 Million to Fund New Center*, GW Hatchet (Dec. 3, 2007).

succeeded in having a district court divert $2.7 million of shareholder's money in a national shareholder class to a local St. Louis charity; the Eighth Circuit reversed the diversion on appeal.[27] In another case, I represent a client appealing an approval of a settlement of a class action with a national class where over $2 million of *cy pres* is going to three San Diego universities (including the *alma mater* of class counsel), class counsel is being paid $8.85 million, but the class will receive only about $225,000 in cash.[28] In another settlement where class counsel was already scheduled to receive $27 million, *cy pres* was designated to a charity run by the ex-wife of class counsel.[29]

In practice, *cy pres* "creates the illusion of class compensation" without actually compensating the class.[30] And as Judge Edith Jones has said, "district courts should avoid the legal complications that assuredly arise when judges award surplus settlement funds to charities and civic organizations."[31]

In recent years appellate courts have started to take a stand against *cy pres* abuses, often at the behest of my non-profit's litigation. In *Oetting v. Green Jacobson*, the Eighth Circuit explicitly adopted Section 3.07 of the American Law Institute's Principles of the Law of Aggregate Litigation:

> A court may approve a settlement that proposes a cy pres remedy . . . . The court must apply the following criteria in determining whether a cy pres award is appropriate:

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[27] *Oetting, supra.*

[28] *In re EasySaver Rewards Litigation*, No. 13-55373 (9th Cir.). I have also previously successfully blocked a diversion of $2.5 million of a settlement fund to third-party charities (including two schools affiliated with class counsel). Alison Frankel, "Legal Activist Ted Frank Cries Conflict of Interest, Forces O'Melveny and Grant & Eisenhofer to Modify Apple Securities Class Action Deal," *American Lawyer Litigation Daily* (Nov. 30, 2010).

[29] *In re: Chase Bank USA NA "Check Loan" Contract Litigation*, No. 09-md-02032 (N.D. Cal.). The conflict of interest was not disclosed to the district court, which approved the settlement.

[30] Redish, 62 Fla. L. Rev. at 623.

[31] *Klier v. Elf Atochem*, 653 F.3d 468, 481-82 (5th Cir. 2011) (Jones, J., concurring). *Accord Ira Holtzman, C.P.A., & Assocs. v. Turza*, 728 F.3d 682, 689-690 (7th Cir. 2013) (Easterbrook, J.).

> (a) If individual class members can be identified through reasonable effort, and the distributions are sufficiently large to make individual distributions economically viable, settlement proceeds should be distributed directly to individual class members.
>
> (b) If the settlement involves individual distributions to class members and funds remain after distributions (because some class members could not be identified or chose not to participate), the settlement should presumptively provide for further distributions to participating class members unless the amounts involved are too small to make individual distributions economically viable or other specific reasons exist that would make such further distributions impossible or unfair.
>
> (c) If the court finds that individual distributions are not viable based upon the criteria set forth in subsections (a) and (b), the settlement may utilize a cy pres approach. The court, when feasible, should require the parties to identify a recipient whose interests reasonably approximate those being pursued by the class. If, and only if, no recipient whose interest reasonably approximate those being pursued by the class can be identified after thorough investigation and analysis, a court may approve a recipient that does not reasonably approximate the interests being pursued by the class.

Cy Pres and Justice Department Settlements

Normally, one would expect Justice Department settlements and public enforcement to avoid the conflicts of interest presented by private enforcement because of the absence of a profit motive. But when the Justice Department has the unfettered power to structure settlements in ways other than direct compensatory relief to victims or payments to the Treasury, it reintroduces the conflict-of-interest problems inherent in litigation on behalf of absent victims.

Settlement *cy pres* by the Justice Department and by state attorneys general present problems beyond the mere conflicts of interest and breaches of fiduciary duty in the private civil litigation context. *First*, such settlements present separation of powers issues. If the Justice Department cannot take money from the U.S. Treasury to fund new programs and third parties without Congressional approval, it should not be able to ignore those checks on its power by structuring litigation settlements to bypass the

Treasury and have defendants to spend that money on the executive branch's preferred priorities—priorities that might never be authorized by Congress.

Second, the *de facto* slush fund created by such Justice Department settlements evades Congressional oversight; neither courts nor the Justice Department are well situated to ensure that *cy pres* is effectively or efficiently used, and there is no evidence that the Justice Department has ever performed that oversight function itself.

Third, such settlements create a conflict of interest that permits Justice Department officials to reward cronies and political allies at the expense of taxpayers. For example, Professor Richard Epstein criticized a Bush administration settlement with Bristol-Myers Squibb requiring them to endow a chair of ethics at the District of New Jersey U.S. Attorney's *alma mater,* Seton Hall Law School; *Investors Business Daily* criticized the recent Bank of America settlement[32] as a "raft of political payoffs to Obama constituency groups."[33]

Fourth, because of that conflict of interest, if executive-branch officials have unfettered authority to use *cy pres* in settlements, they will prefer to structure settlements in a manner that increases their own spending and political power rather than maximizes recovery to taxpayers.

The August 2014 Bank of America and July 2014 Citigroup settlements are especially abusive in this last regard. Justice Department officials issued press releases on July 14 and August 21, 2014, taking credit for a supposed benefits of "$2.5 billion" and "$7 billion" for consumers. But the fine print of each Annex 2 of the two settlements shows that this number is wholly illusory. For example, under Menu Item 4, if Bank of America funds a "Critical Need Family Housing" development, it is entitled to a $3.75 "credit" against the settlement for every $1 of loss Bank of America incurs on the resulting subordinated loan. Citigroup gets a $2 "credit" for every dollar given to qualified non-profit housing counseling agencies—which, as the Investors Business

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[32] http://www.justice.gov/iso/opa/resources/3392014829141150385241.pdf

[33] Richard A. Epstein, *The Deferred Prosecution Racket,* WALL ST. J. (Nov. 28, 2006); Investors Business Daily, *Holder Cut Left-Wing Groups In On $17 Bil BofA Deal* (Aug. 27, 2014). *See also* Bob Goodlatte and Jeb Hensarling, Letter to Eric H. Holder, Jr. (Nov. 25, 2014).

Daily editorial notes, tend to involve friends of the administration.[34] Nothing in the settlement ever requires disclosure to taxpayers who

Bank of America and Citibank also get a $2 credit for every $1 given to IOLTA; many of the resulting legal-aid organization beneficiaries will be able to evade federal-funding restrictions.[35]

It's further questionable whether the settlement should be structuring any consumer relief at all. The settlement is of claims that Bank of America and Citigroup possibly defrauded investors when issuing residential mortgage-backed securities or collateralized debt obligations. If so, billions of dollars for loan modifications to mortgage holders does absolutely nothing to compensate the alleged victims who purchased overpriced RMBS or CDOs and lost money. And it is likely that the consumer relief program will be a fiasco in and of itself. The Home Affordable Modification Program (HAMP) was justly criticized by the Special Inspector General for the Troubled Asset Relief Program because of its 47% re-default rate, which wasted taxpayer money and left many homeowners worse off. The Bank of America settlement credits the defendant for mortgage modifications that are not eligible under HAMP criteria—which will surely result in a higher re-default rate in the long run. And that is before one considers the moral hazard problems and fundamental unfairness of providing benefits to consumers who were financially irresponsible at the expense of consumers who played by the rules and refused to overextend themselves to purchase more housing than they could afford.

If nothing else, it is truly questionable whether the Justice Department can create a more effective consumer relief program than Treasury or Congress or a more effective low-income housing development program than HUD or Congress. The settlement makes public policy decisions that are ultimately counterproductive and certainly not within Justice's expertise. For example, in Menu Item 2.A, Bank of America gets a $10,000 credit in the settlement for every loan made to first-time low-to-moderate-income homebuyers. There are two possibilities: either Bank of America is being incentivized to make loans that would already be financially viable, in which case there is no incremental consumer benefit because the loan would have happened anyway; or Bank of America is being incentivized to make loans that would have an expected value

[34] It is unclear whether such donations to non-profits will also result in tax benefits on top of the settlement's incentives to substitute payments to the non-profits in lieu of direct consumer relief.

[35] *E.g.*, 45 C.F.R. § 1617.

of between zero and negative $10,000—the same sort of distortion of the market that led to expansion of risky mortgages to underqualified buyers that led to the housing crisis in the first place.[36]

The administration of the consumer relief program is a hidden social cost: to ensure compliance, millions of dollars will be spent on lawyers and audits that would have been unnecessary had Bank of America simply written a larger check to the United States Treasury in lieu of spending money on Justice Department public-policy priorities. Why one can understand why Justice Department lawyers might feel that pumping money into the legal economy is a social good, taxpayers would tend to differ.

The Justice Department has traded billions of dollars of leverage in the underlying litigation for an expansion of its own power and an impressive press release, all ultimately at taxpayer expense. And the resulting damage to the future economy from problematic public-policy decisions by Justice Department officials without any regulatory or Congressional oversight may end up costing taxpayers billions of dollars more directly and indirectly.

Section 3.07 of the *ALI Principles* suggests that *cy pres* should never be utilized in Justice Department settlements without express Congressional authorization. If the Justice Department cannot ensure restitution of alleged victims of defendant wrongdoing in settlements, the money is always available for the U.S. Treasury, and Congress can decide whether to create compensation programs, such as HAMP authorized by the Emergency Economic Stabilization Act of 2008; the SEC Fair Funds created by the Sarbanes-Oxley Act of 2002; or the various September 11 Victim Compensation Programs. Such decisions should be made by Congress, and not by a Justice Department operating without oversight.

I welcome your questions.

[36] *E.g.*, Lawrence H. White, *Housing Finance and the 2008 Financial Crisis* (2009).

Mr. MARINO. Thank you, sir.

Ms. Mrose? Am I pronouncing that right?

TESTIMONY OF CORNELIA MROSE, CEO, COMPASS FILMS OF NEW YORK LLC, WESTCHESTER, NY

Ms. MROSE. Hello.

Mr. MARINO. Hello.

Ms. MROSE. Thank you.

Mr. MARINO. Am I pronouncing your name correctly——

Ms. MROSE. Yes, that is perfect.

Mr. MARINO. Mrose?

Ms. MROSE. That was perfect.

Mr. MARINO. Thank you.

Ms. MROSE. Thank you for inviting me. As the Chairman already said, my firm, Compass Films of New York, is going—well, you did not say that. But I am the CEO of the Compass Films of New York, and I am making a film about the true causes of the financial crisis, and how the real culprits are doubling down. And in order to do that, I went and interviewed various people. One of them was the former CEO of BB&T, John Allison. And I want to start off by reading you the answer that he gave to me when I asked him the following question.

So my question to John Allison was this: "Did BB&T make loans it would not have made otherwise in order to keep a good or excellent CRA rating," and "Was BB&T pressured by community activists to make subprime loans or to pledge money for future loans to what they called underserved areas?" "Did you have any direct contact with activist groups?" And his answer was this. "BB&T did make high risk low income loans to meet CRA requirements, and we were pressured to make subprime loans and pledge money by activist groups. All banks paid bribes to CRA groups. I had direct contact with them."

I am quoting this because it sheds light on the enormous power and the political influence on a vast left-leaning non-profit network that exists in the United States today. And I do not have much time, but I am going to focus on this left-leaning network in my 3 minutes remaining. You can read the details in my prepared comments.

First of all, I would like to say that in 1960, the government of the United States gave very little money to non-profit organizations. That has changed dramatically. The Urban Institute published in 2013 a national survey of non-profit groups. It is an excellent survey. It contains a lot of information.

In 2012, government in the United States, Federal, State, and local, gave $137 billion to non-profit groups. $81 billion of those $137 billion went to social service non-profit organizations. These are affordable housing groups, legal aid groups, civil rights groups, ethnic groups. There were approximate 200,000 contracts and grants with about 30,000 of these social service non-profits in 2012. On average, six to seven grants and service contracts, non-profit.

Now, I want to focus on particular group that stands to profit from the particular stipulations in the settlement. The name of this group is NeighborWorks Orange County. It is a 501(c)(3) tax exempt non-profit organization based in Orange County, California.

And I am focusing on this one because it is one of these various groups that are specified in the settlement, a CDFI HUD-approved housing counseling agency, et cetera.

So NeighborWorks Orange County is a chartered member of NeighborWorks America. It is also an affiliate of the National Council of La Raza and CLR. It is a HUD certified housing counseling agency. HUD has, by the way, 2,400 of these approved housing counseling agencies in the United States with about 8,000 housing counselors.

NeighborWorks Orange County is certified by the U.S. Treasury Department as a community development financial institution, a CDFI. The Treasury Department provides funds to CDFIs through various programs, and it is also a community development corporation, a CDC. All these special organizations are listed in the settlement.

How much money did Orange County receive in 2012? It received $3.8 million from the government, from the Federal, State government. It received more money in the past. In 2010 it got around $8 million, and in 2009 it received around $5 million. Not all of the money that NeighborWorks Orange County received came from government entities. Some of it came from taxpayers. And if you look at who gives money to this non-profit, you see that most of these enterprises are banks, so all the big banks. Citibank is there, and Bank of America is there, and Chase, and Wells Fargo, and many other banks, which means that a very small percentage, 3.4 percent, of its money came from private business. 94.6 percent came from taxpayers.

This is quite typical. When you look at such non-profit organizations that many banks contribute to such groups. Why? It is basically protection money. They give to groups that are certified and approved by government agencies. It is an attempt to buy protection against being singled out for punishment by the Department of Justice.

Mr. MARINO. Ms. Mrose, could you wrap up——

Ms. MROSE. Oh, yes.

Mr. MARINO [continuing]. Because your full statement will be made part of the record.

Ms. MROSE. Yes, I certainly will. So I wanted to talk about, and I will not have time to do that, but just briefly. NeighborWorks Orange County, what does it really do? It has 26 employees. And what are they doing? Is it useful to the American citizens, the work they are doing? No. They are basically navigating the various Federal and State government programs designed to let people buy a house who cannot really afford to do so.

So there are example programs like "Making Home Affordable," which is an official program of the Department of the Treasury and HUD, or, of course, HARP, or Keep Your Home California, a program of CalHFA Mortgage Assistance Corporation. That is also a non-profit organization that receives Federal funds, et cetera, et cetera.

Now, you might ask yourself is that a good use of taxpayers' money? Does it really make sense for these 26 employees to spend navigating the labyrinth of government, easy credit access pro-

grams that are also financed by taxpayers all in order to let buy houses that they cannot afford.

Mr. MARINO. Okay, Ms. Mrose, we are running out of time here. So you will be able to address some of those in questions that you are asked, if you do not mind, please.

Ms. MROSE. Thank you.

[The prepared statement of Mr. Mrose follows:]

Prepared Statement of Cornelia Mrose, CEO, Compass Films of New York LLC

Consumers Shortchanged? Oversight of the Justice Department's Mortgage Lending Settlements

1. Is the primary purpose of the Justice Department's record settlements with BofA and Citigroup to provide financial relief to harmed homeowners or is it rather designed to funnel money to politically powerful activist groups?
    a. The settlements order BofA and Citigroup to pay a minimum of $150 million to politically favored non-profit groups like the NCLR (National Council of La Raza) and NeighborWorks America, a congressionally chartered non-profit organization. In 2012, La Raza received about $9 million grant money and NeighborWorks America received $212 million grant money from the government. Both groups function as distributors: they in turn give out grants to smaller alliances and coalitions of non-profits as well as to individual non-profit groups.
    b. In addition, the settlements stipulate that BofA and Citigroup earn 2 dollars' worth of credit against their consumer relief commitment for every dollar they donate above the required minimum but only 1 dollar for every dollar they donate as direct relief to individual homeowners. This is a tremendous incentive for the banks to donate to activist groups and a tremendous disincentive to give money directly to harmed consumers.
2. What is the reason for these extraordinary settlement provisions that seem to have been designed with the intention to benefit a large network of non-profit organizations?
    a. Over the last 50 years, the US government has fostered the creation of an enormous network of left-leaning, non-profit, activist groups. Government – federal, state, local – and non-profit groups have formed a symbiosis whose stated purpose is to help poor and vulnerable citizens thrive. However, the real purpose of this symbiosis is different. It primarily serves to increase the power, control and reach of government via an army of community groups. It increasingly crowds out what is essential for a democratic Republic: a vibrant civic society that is self-reliant and capable of solving problems. Such a civic society is indispensable as buffer between the awesome power of government and individual citizens.
    b. In 1960, the Government of the United States gave very little money to non-profit organizations. This has changed dramatically over the last 50 years. Here are some numbers from the Urban Institute's 2013 National Survey of non-profit groups: in 2012, governments in the US (federal, state and local) gave $137 billion to non-profit organizations in the form of grants or contracts (350,000 grants and contracts with 56,000 nonprofit organizations). Eighty-one billion dollars of those $137 billion went to social service non-profit organizations (affordable housing groups, legal aid groups, civil right groups, ethnic groups). There were approximately 200,000 contracts and grants with about 30,000 social service non-profits in 2012. On average, 6 to 7 grants and service contracts per non-profit.
    c. Social service non-profit organizations are the direct beneficiaries of the unusual settlement terms. More precisely, special kinds of government approved and

government certified non-profits will profit from the $1 dollar paid, $2 dollars credited rule. These groups are HUD approved housing counselling agencies, Community Development Financial Institutions (CDFIs), legal aid organizations that receive funds from IOLTA (Interest on Laywers' Trust Account) and community development corporation non-profits (CDCs). Any surplus amounts and any compensatory payments will go to NeighborWorks America and to organizations that receive money from IOLTA accounts.

3. Let's have a closer look at one of these groups that will profit from the settlements' terms. The group is representative for many.
   a. The name of the group is NeighborWorks Orange County. It's a 501(c)(3) tax-exempt non-profit organization based in Orange County, California. The reason for its public charity status is listed on Schedule A of its 990 form 2012 as: "An organization that normally receives a substantial part of its support from a governmental unit or from the general public."
   b. NeighborWorks Orange County is a chartered member of NeighborWorks America. As previously mentioned, NeighborWorks America is a congressionally chartered non-profit organization. Its real name is Neighboorhood Reinvestment Corporation and it was founded in 1978, the year after the passage of the Community Reinvestment Act. The assistant HUD secretary and a member of the Federal Reserve are on the board of directors together with high officials from other financial regulatory agencies.
   c. In 2012, the group received $212 million from government grants for housing counselling, something called "neighborhood stabilization", community development and foreclosure prevention. The group has around 240 chartered members and it uses its government grants to give out grants itself to its chartered members.
   d. NeighborWorks Orange County is an affiliate of the National Council of La Raza (NCLR). In 2012, La Raza received $9 million in government funds. It also functions as a conduit of grants to other groups.
   a. NeighborWorks Orange County is a HUD certified Housing Counselling agency. There are approximately 2,400 HUD-approved housing counseling non-profits in the US. HUD refers to them as housing counseling agencies. For 2015, HUD received $47 million for its housing counselling partners and is asking for $60 million for 2016. HUD estimates that "HUD Housing Counseling grants will leverage approximately $296 million in other public and private funding."
   b. NeighborWorks Orange County is certified by the US Treasury Department as a Community Development Financial Institution (CDFI). The Treasury Department provides funds to CDFIs through various programs.
   c. NeighborWorks Orange County is a community development corporation (CDC).
   d. In addition, the group functions itself as a distributor of grants and gives out grants to multiple other groups, among them the Legal Aid Society of Orange County which is the recipient of many millions of dollars of government grant money a year and probably also receives money from IOLTA. In 2012, the Legal Aid Society received $165,000 from NeighborWorks Orange County for education and counselling.
   e. In 2012, NeighborWorks Orange County received $3.8 million dollars in government grants. In 2009 it received around $5 million, in 2010 around $8 million and in 2011 around $3 million in grants.
   f. Not all of its money came from taxpayers. In 2012, NeighborWorks Orange County received $135,000 from private enterprises, almost all of them banks (among them are

Bank of America, Citibank, Chase and Wells Fargo). Which means that 3.4% of its money came from private business and 94.6% from taxpayers. It's typical that so many banks contribute to a housing non-profit like NeighborWorks Orange County. It's basically protection money. Donating to groups that are certified and approved by government agencies is not rarely an attempt to buy protection against being singled out for punishment by the Department of Justice.

g. Because of the layering effect of government fund distribution, it is not at all immediately obvious how reliant these non-profits are on government funding. Without taxpayer funding, few groups would survive.
h. As a HUD housing counselling agency, a CDFI and a chartered member of NeighborWorks America, NeighborWorks Orange County is perfectly positioned to receive funds from the BofA and Citigroup settlements. It's in the interest of both banks to donate huge amounts of money above the required minimum to groups like NeighborWorks Orange County because of the massive incentive given through the "pay 1 dollar, receive 2 dollars in credit" rule.

4. What is NeighborWorks Orange County actually doing with the millions of dollars of government money?
    a. In 2012, $1.8 million were paid to the group's 26 employees. That's an average salary of about $80,000 per employee.
    b. More than $200,000 were given as grants to other activist groups.
    c. Payments to affiliates totaled more than one million dollars.
    d. Management, legal expenses, accounting, office expenses, travel, conferences, insurance and other expenses amounted to about 800,000 dollars.
    e. What exactly are its 26 employees doing? They are navigating the various federal and state government programs designed to let people buy a house who can't afford to do so and to avoid foreclosure for those who cannot pay their mortgages. Examples are programs like "Making Home Affordable" which is an official program of the Departments of the Treasury and HUD or HARP, The Home Affordable Refinance Program, or Keep Your Home California, a program of the CalHFA Mortgage Assistance Corporation, a nonprofit organization that receives federal funding for California homeowners. The group also has access to down payment assistance programs that are only available through non-profit organizations. An example of such a program is the CalHome Loan Program. By the way, the group also works as a real estate agency listing houses for sale and it will as it says on its website "aggressively market your property."
    f. You might ask yourself if NeighborWorks Orange County's $3.5 million of taxpayer money is well spent navigating the labyrinth of government easy credit access programs that are also financed by taxpayers. And all in order to let people buy houses that they cannot afford. This is a service to whom exactly? It's amazing to have to ask that question just 7 years after the financial meltdown.
    g. It seems then that Bank of America's punishment consists in forcing it to finance exactly the same kind of behavior that Bank of America is being punished for. It gets even more hair-raising when you consider that BofA itself had very little bad mortgage paper on its books and was pressured by the government to buy two failing companies, Merrill Lynch and Countrywide, who had lots of it.

5. The Crony Advocacy Cycle: symbiosis of government and non-profit organizations
    a. Billions of dollars of taxpayer money flow each year from executive agencies and congressional appropriations to a vast network of politically progressive, activist groups.

Many of these groups are driven by ideological visions of achieving economic equality via distribution and retribution. Overall, they are far to the left of the American public. Politically, they are enormously powerful. Some of them have access to the highest levels of state and federal government. Executive agencies like HUD refer to them as partners and as private non-profit agencies.

b. What role do the activists play in shaping government policies, laws and regulations? Let's have a look at another concrete example: the NCLR, National Council of La Raza. The group receives millions of dollars in government grants each year. Between 1989 and 2014, the organization's political action committee, its employees and their family members spent around $100,000 in campaign contributions on individual politicians on the federal level. The lion's share went to Democratic members of Congress. During the same time period, La Raza spent more than $6 million dollar on lobbying efforts, in particular on immigration and health legislation.
c. Between 2002 and 2014, the NCLR submitted at least 26 comments on proposed federal regulations. Several of its employees sat or are sitting on federal advisory committees. In fact, activist groups often closely participate in administrative lawmaking as well as in rule execution and rule enforcement. The NCRC, National Community Reinvestment Coalition, for example, is one of several extremely influential affordable housing non-profits that are currently working with HUD on re-writing AFFH regulation (AFFH stands for Affirmatively Furthering Fair Housing).
d. Not only does Congress delegate significant parts of its legislative powers to executive agencies, executive agencies delegate parts of their administrative lawmaking power to their crony non-profits partners as well as to crony capitalists. In 2010, for example, the FCC proposed net neutrality regulation and asked six industry lobbyists to draft the rules. This double and triple delegation of power is unconstitutional as is brilliantly explained and put into deep historical context by Prof. Philip Hamburger (Columbia Law School) in his new book "Is Administrative Law unlawful?"

Conclusion:

A new dimension is added to the crony advocacy system with the BofA and Citigroup settlements: the terms of the settlements partly order and partly incentivize the two banks to directly contribute massive amounts of money to the government/non-profit complex. The $1:$2 ratio incentive shows clearly where the government wants banks to spend their money: not on individual customers (which would be the direct and efficient customer relief) but on crony non-profit groups.

On the surface, these groups are private, tax-exempt non-profit organizations. In reality, they have - over the last twenty years or so - mutated into hybrid entities, wiping out the clear line between public and private sector. This is a dangerous development since a society needs lots of government free breathing space to be creative, productive, prosperous and happy.

Mr. MARINO. Professor White?

TESTIMONY OF ALAN M. WHITE, PROFESSOR OF LAW, CUNY SCHOOL OF LAW, NEW YORK, NY

Mr. WHITE. Thank you, Mr. Chair, and Mr. Ranking Member, Members of the Committee for the invitation to testify today. As you mentioned, I have a great deal of experience doing research on the mortgage market and on the foreclosure crisis. And I did want to mention that for 24 years I represented low income homeowners in foreclosure cases in Philadelphia, Pennsylvania.

I make a number of points in my written testimony. I would like to just focus my 5 minutes on two points about legal aid organizations and housing counselors. And to say, first of all, that directing money to these groups is an effective and perhaps the most effective way of remedying the injury that the Federal lawsuits were designed to remedy. That is, to compensate both homeowner consumers and as well investors who lost billions, possibly trillions, of dollars as a result of the fraud that is the subject of the lawsuits.

The second point I want to make is about the accountability of legal aid and housing counseling agencies because I have both personal and professional knowledge about that. So let me first talk about effectiveness. There is considerable empirical research, and I cite it, that demonstrates that having a housing counselor or a legal aid lawyer, for example, for the Delaware couple that the Chairman mentioned earlier, will greatly increase the chances of a successful workout with the bank, so that a thousand or two spent on a housing counselor or a legal aid lawyer can save the homeowner's home and prevent a loss that is typically going to run in the hundreds of thousands of dollars for the bank and for the investors. And I do not think there is really any controversy about that.

I would also like to say that most of the housing counseling agencies are not these activist groups that we hear about. For example, I believe in Williamsport, Pennsylvania, the primary housing counselor is Consumer Credit Counseling of Northeast Pennsylvania, an organization I am a little bit familiar with because of some foreclosure crises that occurred in the Poconos while I was practicing.

The consumer credit counseling agencies were set up originally funded by the banks to advise consumers on how to deal with unmanageable credit card debt. And after the foreclosure crisis, they began to get into the business of helping people navigate their way through the very difficult process of workouts with banks. So the consumer credit counseling services, some of the faith-based organizations, veterans groups. There are lots and lots of groups that are both very effective at this work and that I think if Bank of America and Citibank choose to fund them and to avoid activist groups, they can certainly do that.

On the accountability point, there have been some settlements at the State level. State attorneys general have done things similar to what Justice has done with this settlement in directing funds to legal aid and housing counseling networks. And I spoke with somebody I know who helps to administer the New York Attorney General's program, and she assures me that every contract with every

housing counselor and every legal aid agency specifies exactly what they can and cannot do with the funds.

And, of course, we do not know what Bank of America or Citibank's contracts with whoever they choose to fund are going to provide. But there is every expectation that they are going to restrict the use of the funds to the activities specified in the settlement. And I can tell you from experience that those kinds of nonprofits, housing counselors, and legal aid organizations do detailed cost accounting.

We kept time records in which we accounted for every 10 minutes of every hour and specified what activity we were engaged in, and which funding source was paying for that activity. And I can certainly assure you that if we violated the terms not only of government funding at the Federal or State level, but even private funding from foundations, our auditors would point that out, and we would have a problem. And the housing counseling agencies typically operate on that model. They are very carefully overseen and audited.

Part of the difficulty with this hearing is we do not really know exactly how the banks are going to administer these programs. And as far as I know, I do not think they have gotten very far. From everything I have heard from inquiring, they have not actually picked who the groups are going to be and how they are going to administer the funds. It is a relatively small portion obviously of the programs they have to implement. But I have every expectation that the banks will establish the same kind of contractual restrictions that we have seen in other settlements. And so, so the idea that a small amount of money is going to be misdirected toward political activism seems to me unlikely in the extreme.

So I did want to focus on the counseling agencies on the legal aid providers because I think that a lot of the publicity about this issue has really been unfortunate in mischaracterizing who they are and what they do. And they are, as I say, an extremely effective and useful means of remedying the wrong that these lawsuits were intended to remedy.

So with that, I will answer any questions you might have.

[The prepared statement of Mr. White follows:]

Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law
Oversight Hearing on "Consumers Shortchanged? Oversight of the Justice Department's Mortgage Lending Settlements"
February 12, 2015
Testimony of Alan M. White, Professor, CUNY School of Law

Thank you for inviting me to testify today. My primary research focus for the past eight years has been the mortgage market, the foreclosure crisis and the regulation of credit more generally. I am currently serving as the co-reporter for the Uniform Law Commission's project on a model Foreclosure Procedures Act. In that capacity I have also conducted substantial research on mortgage servicing, foreclosure litigation and mediation and loss mitigation programs.

Let me begin by setting the record straight concerning the claim that the 2013-2014 federal-state task force settlements with Citigroup, J.P. Morgan and Bank of America compel the banks to fund activist groups, and to divert large sums from consumer relief for that purpose. That claim does not square with the facts.

First, it is entirely up to the banks which legal aid agencies and housing counselors to fund. The banks may choose from hundreds of housing counselors and legal aid agencies, including many faith-based organizations and nonpartisan community development groups whose political orientations range from left to centrist to nonpartisan to right. If a bank sees a particular nonprofit agency as too controversial, because of the work that agency does with its other funding, the bank can simply leave the group off of its donation list. Second, less than one percent of the consumer relief dollars in these settlements is earmarked for housing counselors and legal aid. There is simply no significant diversion of money from the billions in required consumer relief. Third, as I will explain in more detail, the nonprofit legal aid and housing counseling agencies are all subject to auditing and oversight that prevents misuse of public and private funds for political activity of any kind.

I would like to focus my testimony on three more substantive points concerning the consumer relief provisions of the three federal-state task force settlements with Citigroup, Bank of America and J.P.Morgan.

First, the settlement agreement provisions to incentivize banks to write down mortgage principal for underwater homeowners are critical to homeownership preservation and full housing market recovery. Second, housing counseling and legal services provided by a full range of nonprofit organizations are highly effective to enable homeowners to access consumer relief in the settlements, to increase successful mortgage workouts, and to prevent further losses for mortgage investors; indeed, I would urge the banks to spend substantially more than the required minimum on these services. Third, government and private funding for legal services and housing counselors always comes with necessary oversight, auditing and reporting to prevent misuse of funds.

1) The settlement incentives to encourage principal reduction for underwater homeowners will save homes, preserve neighborhoods, prevent further investor losses and aid the housing market recovery.

Although the foreclosure crisis is finally abating, we still have an inventory of roughly 2 million homes in foreclosure. The percentage of mortgages in foreclosure stands at 2.39%,[1] still far exceeding the foreclosure rate at the peak of the Great Depression in 1933.[2] One in six homeowners is still underwater, a historically unusual and precarious situation where middle class Americans are paying down home debt that is more than their homes are worth[3]. Historically low interest rates are reducing payment strain on homeowners, but the persistence of serious negative equity remains an obstacle to full recovery, for households and for the housing market.

We now know, seven years into the foreclosure crisis, that well-designed loan modifications work very well for homeowners and for investors, and that there are still not enough well-designed loan modifications. The most recent Office of the Comptroller of the Currency mortgage metrics report reveals that redefaults on modified loans have dropped from more than 50% in 2008 to less than 20% now, and less than 15% for HAMP modifications with significant payment reductions.[4] We also know that modifications with principal reduction perform much better than those where the bank adds delinquent payments to the total balance. So if our objective is to work through the remaining inventory of homes in foreclosure or serious default with minimal losses to homeowners and investors, principal reductions will be an important tool.

We also know that the banks have performed poorly in resolving defaulted mortgages. Some servicers have much higher rates of successful mortgage modifications than others, and the large bank servicers consistently have the worst performance.[5] The enforcement actions and settlements by the Federal Reserve,

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[1] Mortgage Bankers Association of America, National Delinquency Survey 3rd Quarter 2014, http://www.mba.org/NewsandMedia/PressCenter/89895.htm.
[2] David C. Wheelock, The Federal Response to Home Mortgage Distress: Lessons from the Great Depression, 90 *Federal Reserve Bank of St. Louis Review* 133, 139 (May/June 2008) (noting that foreclosure rate would have been far higher but for state moratoria and New Deal programs).
[3] Zillow Negative Equity Report, 3rd Quarter 2014, http://www.zillow.com/research/negative-equity-2014-q3-8532/.
[4] Office of the Comptroller of the Currency, Mortgage Metrics Report 3rd Quarter 2014, http://www.occ.gov/publications/publications-by-type/other-publications-reports/index-mortgage-metrics.html.
[5] Sumit Agarwal, et. al., Policy Intervention in Debt Renegotiation: Evidence from the Home Affordable Modification Program (Federal Reserve Bank of Chicago 2013) http://ssrn.com/abstract=2369419; Alan M. White, Deleveraging the American

FDIC and other regulators attest to this systemic failure.[6] It is therefore completely appropriate for the federal-state task force settlement to create strong incentives for better foreclosure prevention and loss mitigation by the major bank servicers as the foreclosure crisis continues to wind down.

Congress could help banks, homeowners and mortgage investors by extending the Mortgage Forgiveness Debt Relief Act, which expired at the end of 2014. A homeowner whose bank agrees to make their home loan affordable shouldn't be confronted with an unaffordable federal income tax bill. If Congress extends this tax relief measure, the banks could then put the consumer relief dollars in the settlements to better use.

2) Legal aid and housing counseling are very effective at reducing foreclosure losses for homeowners and investors.

Empirical research consistently shows that housing counseling and legal representation are effective in preventing preventable foreclosures.[7] The reasons counselors and legal aid lawyers are helpful are fairly obvious. Servicers have done a poor job of communicating with homeowners and restructuring their loans. Homeowners facing foreclosure are sometimes reluctant to engage with their servicer, have difficulty organizing paperwork to respond to bank requests, and aren't familiar with the different alternatives to foreclosure and who is eligible for

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Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications, 41 *Conn. L. Rev.* 493 (2009).

[6] *See* Federal Reserve Board April 2011 press release regarding enforcement actions against 10 banking organizations, http://federalreserve.gov/newsevents/press/enforcement/ 20110413a.htm; Justice Department press release on 2012 national mortgage settlement, http://www.justice.gov/ust/eo/public_affairs/consumer_info/nms/.

[7] Kenneth Temkin, et. al.,National Foreclosure Mitigation Counseling Program Evaluation, Final Report (September 2014) http://www.neighborworks.org/Documents/HomeandFinance_Docs/Foreclosure_Docs/ForeclosureCounseling(NFMC)_Docs/2014_NFMC_UrbanInstituteReport.aspx; J. Michael Collins & Maximilian D. Schmeiser, The Effects of Foreclosure Counseling for Distressed Homeowners, 32 *J. Policy Anal. & Mgt.* 83 (2012); Neil Mayer, et. al., Has Foreclosure Counseling Helped Troubled Homeowners? Evidence from the Evaluation of the National Foreclosure Mitigation Counseling Program (2012), http://www.urban.org/UploadedPDF/412492-Has-Foreclosure-Counseling-Helped-Troubled-Homeowners.pdf; Ding, Lei, Robert G. Quercia, and Janneke Ratcliffe, Post-purchase Counseling and Default Resolutions among Low- and Moderate-Income Borrowers, 30 *Journal of Real Estate Research* 315-344 (2007); Maggie Barron & Melanca Clark, Foreclosures: A Crisis in Legal Representation, http://www.brennancenter.org/page/-/Justice/Foreclosure %20Report/ForeclosuresReport.pdf.

them. Banks repeatedly lose homeowner paperwork and make frustrating and duplicative requests.

Counselors and legal aid lawyers have expertise in the variety of loss mitigation programs and the paperwork needed to apply, and they serve a vital function by persistently following up with both homeowners and servicers to bring workout requests to a conclusion. Counselors and lawyers know about the various federal and state legal settlements, and know how to connect homeowners with these new consumer relief programs.

Successful outcomes facilitated by lawyers and housing counselors include not only loan modifications and repayment plans, but also negotiated short sales and deeds in lieu of foreclosure. All of these outcomes are better for both the homeowners and mortgage investors. Every successful resolution arranged by a housing counselor, even a short sale, mitigates foreclosure losses to investors, including of course the GSEs.

This point bears emphasizing. The average investor loss on a single foreclosure home sale is roughly $100,000.[8] Money spent on housing counseling pays off, both for moderate-income homeowners who can renegotiate their mortgage, or at least negotiate a graceful exit, and for investors, who save tens of thousands of dollars on each foreclosure sale that is prevented.

3) Housing counselors and legal aid agencies are subject to rigorous oversight to prevent misuse of funds, such as for political activity

The Citigroup and Bank of America settlements require minimum contributions of $15 million and $30 million, respectively, for state legal aid funders, and $10 million and $20 million, respectively, for HUD-approved counseling agencies to provide foreclosure prevention services. Apart from minimum distributions in the participating states, there are no restrictions on how the banks may achieve these targets. In particular, the language of the settlement agreements leaves to Citigroup and Bank of America the decision of which housing counselors are to receive donations. For legal aid, the donations are to be directed to state interest on lawyer trust account (IOLTA) programs, the vast majority of which are administered by nonpartisan state bar associations or affiliated nonprofits.[9]

HUD-approved housing counselors include

-nonprofit consumer credit counseling agencies first established with support from banks to help consumers manage credit card debt, like Consumer Credit Counseling Services of Northeastern Pennsylvania

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[8] Alan M. White, Deleveraging the American Homeowner, 41 *Conn. L. Rev.* 1107, 1119 (2009).

[9] For a directory of state IOLTA programs, *see* www.iolta.org.

-faith-based organizations that work on getting low- and moderate-income families into affordable housing and helping them avoid evictions and foreclosures, like Metro-Interfaith Housing Management in Binghampton, New York, Neighborhood Christian Legal Clinic in Indianapolis, and Council of Jewish Organizations of Flatbush in Brooklyn, New York,

- state housing finance agencies, and

-local community development organizations dedicated to housing and small business development in their communities.[10]

Interestingly, the settlement documents give the banks credit only for money going to the housing counselors, and not for state or national intermediaries like Neighborworks to distribute the funds and monitor their use. Presumably the banks will decide whether to contract with intermediaries or find another way to administer the distribution of funds.

HUD-approved counseling agencies receive federal, and in some cases, state funding support. They are therefore subject to detailed reporting and auditing requirements, designed to insure that funds are used for approved activities only. For example, in my state of New York, the Center for New York City Neighborhoods and the Empire Justice Center in Albany administer funds from the 2012 national mortgage settlement. Each housing counseling agency and legal aid provider must sign a detailed contract with the Office of the Attorney General to receive funds. The contracts make clear what activities are permitted, and prohibit lobbying or other misuse of funds. The contracts require housing counselor grantees to submit bimonthly reports with numerous data points, including the number of homeowners served and the foreclosure avoidance outcomes achieved.

Individual housing counselors must be trained and certified in accordance with the National Industry Standards for Homeownership Education and Counseling.[11] The National Industry Standards Committee developed these standards. Citigroup, Bank of America and Chase are all members of the NISC.

Housing counseling agencies typically receive funding from many sources, they must engage in detailed cost accounting, and they must submit activity reports to both government and foundation funders. There is no reason to believe the banks will not use similar contract oversight in complying with the settlements.

Legal aid agencies uniformly require their attorneys to keep time records and allocate every hour of every day to federal, state, local government funding or

[10] A full list of HUD-approved housing counseling agencies is available at http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm.

[11] http://www.homeownershipstandards.org/Home/Home.aspx

private grant sources, with detailed activity descriptions. The reports are audited by the federal Legal Services Corporation and state funders, and staff at these programs are keenly aware that they are accountable for any unauthorized use of funding, including for any prohibited political activity.

IOLTA-funded legal aid providers and HUD-approved counseling agencies count among them nonprofits with a wide variety of missions, religious and ideological viewpoints. It is preposterous to characterize a broad program of funding to these agencies as funneling money to left-wing activists, right-wing activists, religious zealots, or any other disfavored political group. What all these counseling agencies have in common is a commitment to putting American families into decent and affordable homes and keeping them there. The campaign of misinformation regarding the required bank support for legal aid and homeowner counseling does a serious disservice to these agencies, and to America's struggling homeowners.

Mr. MARINO. Thank you, sir. I am going to start out by asking my 5 minutes of questions. I will start with Professor White. I do not know if it is coincidental that you used my hometown in Williamsport, Pennsylvania or if that is where you knew I came from?

Mr. WHITE. That is not a total coincidence. I grew up in State College.

Mr. MARINO. Nevertheless, I agree with just about everything you said. I think the agencies, what they are designed for are good. But it should be focusing on people who are in the process of losing their homes and not handling issues where people have already lost their homes unfortunately, and it perhaps should have been done that way to begin with. And you say, well, we do not know yet. That is exactly what we do not know.

DoJ will not turn over any information that we have asked for concerning who, what, where, and when. Where does this money come from and how is it spent? And you are right. Legal aid, which I have dealt with as a district attorney and even as a U.S. attorney, these people do a great job in defending those that cannot afford it, but they are very regimented. And my good friends on the other side and you have even stated to a certain degree that we are only talking about a little bit of money. I do not care if it is a thousand dollars. It is still taxpayers' money that has to be accounted for.

But you know what the issue is here, Professor? The issue is Congress appropriates, not the Justice Department. And the Justice Department has taken this on itself to determine how these settlements are going to be made. I do not agree with the 2-for-1 for the 3-for-1 credit. This all boils down to who has the authority to appropriate, and it is Congress. And what say you, sir?

Mr. WHITE. Well, I guess I would say I respectfully disagree with a couple of your points.

Mr. MARINO. Well, let us start ticking them off.

Mr. WHITE. As far as the constitutional issue about appropriations, that is not really my specialty. I will say I do teach remedies, and the idea that——

Mr. MARINO. It is one of my specialties because I pay a lot of attention to it. And so, the Constitution is very clear. I think some of my colleagues agree with me that unless we specifically state by statute, nobody, not the executive branch, not the judicial branch, has a right to appropriate money. Do you disagree with that, sir?

Mr. WHITE. I do not think that is a characterization of what the Justice Department is doing here. I do not think they are appropriating taxpayer funds. I think they are——

Mr. MARINO. Well, they are using extortion to make banks——

Mr. WHITE. If I could continue——

Mr. MARINO [continuing]. Appropriate funds to left-leaning organizations. Now, there is no accounting at this point as to how this money is being appropriated, whether Justice hands it out or they tell a bank to hand it out a certain way. So what would be your recommendation as to how we can account for this? What is wrong with this process, turning the money over to the Treasury, the Treasury then allocating that money through legislation that we in Congress can legislate, and follow, and have oversight on it? Now what is wrong with that process, sir?

Mr. WHITE. I would be totally in favor of Congress appropriating more funds for housing counseling and legal services.

Mr. MARINO. So they are not doing that, though.

Mr. WHITE. Listen——

Mr. MARINO. Pardon me?

Mr. WHITE. With all due respect, those two approaches are not mutually exclusive. Negotiating remedies for victims in lawsuits and Congress appropriating funding for similar activity, those are both——

Mr. MARINO. Congress has not appropriated the funding on this specific issue. These agencies also receive money through HUD, so in addition there is a double dip there. So, I am sorry, I do not agree with you that this is a legitimate way to establish appropriation. Show me a statute where it says that the Justice Department has the authority to negotiate with banks that they can give money to left-leaning organizations.

Mr. WHITE. Well——

Mr. MARINO. You cannot do that, sir.

Mr. WHITE. That is a compound question. I would object——

Mr. MARINO. Well, you are an attorney. You are a professor. You should be answer. I am sure you have compound questions on your law school exams.

Mr. WHITE. They are not left-leaning organizations, first of all. Secondly, the Justice Department is not, as I understand it, proposing to appropriate any taxpayer funds. They are simply negotiating restitutionary relief, which State attorneys general and the Justice Department does all the time. Not only do you seek an award of fines that are paid to the Treasury, but you seek restitution to be paid to the victims of the misconduct.

Mr. MARINO. Exactly right, sir. And as a U.S. attorney, I did the same thing on the criminal side and on the civil side. And whether there is a violation on the criminal side or whether there is a breach of the civil side, the restitution, the fines, are taxpayer dollars.

Mr. Larkin, you have heard the answers by Mr. White. What say you?

Mr. LARKIN. You can only give out—my apology. You can only give out money in restitution if there is a statute that authorizes you to give out money in restitution. If the Department is working in a criminal case where there is statutory authority to see that victims of crime receive some type of financial compensation, and the Department does it best to make sure that victims get that compensation, the Department is acting within the law.

But if the Department is owed a check by a private party, the law requires that that check be deposited into the Federal Treasury, and if there is no statute that allows them to negotiate a restitution agreement or any type of agreement with a civil defendant or a criminal defendant, the Department cannot do that.

Mr. MARINO. Thank you, sir. My time has expired, and now I recognize the gentleman from Michigan, the Ranking Member, Mr. Conyers.

Mr. CONYERS. Thank you, Mr. Chairman. I ask unanimous consent to place into the record the Congressional Research Service

memo on the principles associated with monetary relief provided as part of financially related legal settlements.

Mr. MARINO. Without objection.

[The information referred to follows:]

Congressional Research Service
Informing the legislative debate since 1914

MEMORANDUM February 9, 2015

From: David H. Carpenter, Legislative Attorney, 7-9118

Subject: **Legal Principles Associated With Monetary Relief Provided as Part of Financial-Related Legal Settlements & Enforcement Actions**

This memorandum is designed to be distributed to multiple congressional offices.

In the wake of the recent housing and financial crises, the United States Department of Justice (DOJ) and other federal regulators have entered into numerous legal settlements with and enforcement actions against financial institutions for alleged unlawful foreclosure practices and violations of securities laws, among others. These settlements and enforcement actions have resulted in financial institutions paying tens of billions of dollars in cash penalties, restitution, and other forms of relief to state and federal parties and programs, as well as individual consumers and other private actors. This memorandum provides a general overview of *what form* the cash and other relief might take, *who* is legally permitted to take possession or advantage of such relief, and for *what purpose*. This memorandum is designed to be distributed to multiple congressional offices.

Forms of Relief

Federal agencies with enforcement powers typically have tremendous flexibility to craft the terms of legal settlements with entities for alleged misbehavior.[1] The terms of a legal settlement that are negotiated between the parties[2] might be affected by myriad factors, such as the estimated additional costs (financial, reputational, etc.) of litigation, estimated time it would take to complete litigation, and uncertainty of success or failure if the matter is litigated. The terms of a settlement also will be impacted by the scope of a particular regulator's authority and the maximum relief available by law for the specific alleged behavior. In some instances, multiple state and federal entities will have jurisdiction over the same or related alleged misconduct, and these parties might coordinate settlement negotiations. Possible relief could take numerous legal forms, such as civil money penalties, civil forfeiture, or restitution to harmed investors, consumers, or public programs. To whom such relief will be paid and remitted and for what

[1] This is a form of enforcement discretion. For background on enforcement discretion, see CRS Report R43708, *The Take Care Clause and Executive Discretion in the Enforcement of Law*, by Todd Garvey. The discretion is not limitless. See, e.g., GAO-B-210210, *Donations Under Settlement Agreements*, Sept. 14, 1983 (GAO determination that the Commodity Futures Trading Commission would exceed its prosecutorial authority by "accepting a charged party's promise to make an educational donation as all or part of a settlement agreement ... [because, although] [d]onations would be contractually tailored to aid in the fulfillment of one of the Commission's statutory goals, ... [s]uch donations are not reasonably related to prosecutorial authority.").

[2] Legal settlements often must be approved by a court for various reasons, including to ensure their terms are enforceable by and in compliance with the law.

purpose, will depend on the precise details of the settlement terms, what legal form the relief takes, and the statutory authorities governing how an agency or program may use monies it receives.

A recent agreement between Bank of America (BOA) and DOJ and other federal and state regulators, although somewhat unique in size, is illustrative of the significant discretion that regulators have to craft legal settlements.[3] On August 21, 2014, the DOJ announced a nearly $17 billion Legal Settlement with BOA to settle civil claims involving the company's securitization, issuance, marketing, and sale of residential mortgage-backed securities (RMBS) and collateralized debt obligations (CDOs). According to DOJ, the BOA settlement represents the largest civil accord with a single company in U.S. history.[4] The monetary relief provided by BOA took multiple forms, including civil money penalties, remediation to federal and state parties harmed by BOA's alleged misdeeds, consumer tax relief, and consumer mortgage/foreclosure relief. Some portions of the $17 billion settlement went to federal agencies. Others went to state entities, while still other portions will go to consumers.[5]

More specifically, BOA paid $9.65 billion in civil penalties and "compensatory remediation payments" to the parties[6] and will provide an additional $7 billion in Consumer Relief.[7] The Consumer Relief could take the form of mortgage modifications and refinancings for troubled mortgage borrowers, mortgage down payment assistance, and community reinvestment.[8] The distribution of the Consumer Relief will be overseen by an independent monitor.[9]

Of the cash payments, BOA paid approximately $7 billion to settle claims with the DOJ. Of that approximately $7 billion, $5 billion represents a civil penalty assessed under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).[10] Other claims settled with the DOJ are associated with several sealed lawsuits ($1.05 billion)[11] and various reimbursements for mortgage

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[3] Bank of America Legal Settlement, Aug. 20, 2014, available at http://www.justice.gov/iso/opa/resources/9622014821111642417595.pdf.

[4] *Bank of America to Pay $16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis*, Dept. of Justice Press Release, Aug. 21, 2014, available at http://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading.

[5] Bank of America Legal Settlement, at 5-9.

[6] The plaintiff parties are: DOJ, the Commonwealth of Kentucky, and the states of California, Delaware, Illinois, Maryland, and New York. The defendant parties are: Bank of America Corporation, Bank of America, N.A., Banc of America Mortgage Securities, and their former and current affiliates and subsidiaries. Additionally, the Federal Deposit Insurance Corporation and the Securities and Exchange Commission entered into distinct but related agreements with the defendant parties.

[7] *Bank of America Reaches Comprehensive Settlement With U.S. Department of Justice and State Attorneys General to Resolve Mortgage-related Litigations and Investigations*, Bank of America Press Release, Aug. 21, 2014, available at http://www.sec.gov/Archives/edgar/data/70858/000007085814000097/bac-exhibit991082114.htm.

[8] Bank of America Legal Settlement, Annex 2 Consumer Relief, available at http://www.justice.gov/iso/opa/resources/8492014829141239967961.pdf. The settlement agreement permits BOA to earn Consumer Relief credits ($0.50 of credit for every $1.00 provided) to "community reinvestment and neighborhood stabilization" by providing: principal forgiveness to occupied properties; paying for property rehabilitation and demolition of "abandoned and uninhabitable residential properties as part of a comprehensive local strategy to stabilize neighborhoods;" the donation of REO (residential owned) properties and mortgages to cities, nonprofit organizations, land banks, disabled servicemembers, or survivors of deceased servicemembers; donations of uninhabitable or abandoned properties to nonprofit organizations; donations to Community Development Financial Institutions and organizations or local governments that offer similar community development services; donations to organizations that provide foreclosure prevention- or community development-related legal services, such as state IOLTA (Interest on Lawyers' Trust Account) organizations; and donations to HUD-certified counselors. *Id.* at 6-8.

[9] Bank of America Legal Settlement, at 8-9.

[10] *Id.* at 5-6

[11] *Id.* at 6.

insurance claims erroneously paid by the Federal Housing Administration (FHA) ($800 million)[12] and reimbursements for erroneously paid MBS guarantees by the Government National Mortgage Association (Ginnie Mae) ($200 million)[13][14] as a result of BOA's alleged misconduct.

Additionally, BOA paid a little over $1.3 billion to settle claims with the Federal Deposit Insurance Corporation (FDIC), and approximately $245 million to settle claims with the Securities and Exchange Commission (SEC). The payments to the FDIC were in its capacity as receiver[15] for 26 failed depository institutions to cover various legal claims, including alleged securities fraud associated with RMBS purchased by the failed depositories from BOA.[16] The payments to the SEC cover alleged violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 and took several different forms, including more than $129 million in civil penalties, nearly $110 million in disgorgement, and $6.62 million in prejudgment interest.[17] BOA also paid just under $1 billion combined to settle claims with the six state parties.[18] In addition to the $9.65 billion in cash payments to federal and state parties, BOA also set aside more than $490 million in a Tax Relief Payment Account to cover consumers' tax liabilities resulting from receipt of the Consumer Relief component of the settlement.[19]

Who May Obtain Monetary Relief and for What Purpose?

A frequent question that arises in the context of these complex legal settlements is what the federal agencies and other parties that receive monetary relief may legally do with those monies. The answer to that question depends on both what form the monetary relief takes (e.g., civil money penalties, remediation) and what statutory obligations bind the receiving party.

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[12] *Id.*

[13] *Id.*

[14] *Id.* at 9-12.

[15] For more information regarding the FDIC's role as receiver of failed depository institutions, see, *infra*, n. 34-37 and surrounding text.

[16] Bank of America Legal Settlement, Exhibit A, available at http://www.justice.gov/iso/opa/resources/3492014829141527747058.pdf. See also *FDIC Announces Settlement With Bank of America: Settlement of Claims Totals $1.03 Billion*, Fed. Deposit Ins. Corp. Press Release, Aug. 21, 2014, available at https://www.fdic.gov/news/news/press/2014/pr14069.html.

[17] Bank of America Legal Settlement, Appendix B, available at http://www.justice.gov/iso/opa/resources/4792014829141540824781.pdf; Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Order and Civil Penalty, In the Matter of Bank of America, Corp., Sec. and Exchange Comm'n, Administrative Proceeding No. , Aug. 15, 2014, available at http://www.justice.gov/iso/opa/resources/4792014829141540824781.pdf and Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Order and Civil Penalty, In the Matter of Bank of America, Corp., Sec. and Exchange Comm'n Administrative Proceeding No. 3-16028, available at http://www.sec.gov/litigation/admin/2014/34-72888.pdf.

[18] Bank of America Legal Settlement, pp. 7-8 ($300 million to California; $300 million to New York; $200 million to Illinois; $75 million to Maryland; $45 million to Delaware; and $23 million to Kentucky).

[19] Bank of America Legal Settlement, Annex 3, available at http://www.justice.gov/iso/opa/resources/4922014829141329620708.pdf.

The "miscellaneous receipts statute,"[20] establishes the general rule of law that when a federal agency collects money, those funds *typically* must be remitted to the U.S. Treasury's general fund as "miscellaneous receipts." The statute states, in relevant part:

> ... an official or agent of the Government receiving money for the Government from any source shall deposit the money in the Treasury as soon as practicable without deduction for any charge or claim.[21]

Once money is remitted to the general fund in any form (e.g., individual income tax payment, civil money penalty, etc.), it "can not [*sic*] be withdrawn except in consequence of [an] appropriation made by law."[22] The miscellaneous receipts statute provides a means "by which Congress retains control of the public purse under the separation of powers doctrine."[23]

However, there are several categories of exceptions to this general rule, including: (1) "refunds"; (2) explicit statutory exceptions; and (3) payments that are not "for the Government."[24]

"Refunds"

Refunds in this context are repayments for expenditures made in error or in excess of what was actually owed. Refunds are a nonstatutory exception to the miscellaneous receipts statute that "simply restore[] to the appropriation amounts that should not have been paid from the appropriation."[25] A refund includes repayment for actual damages caused by erroneous or excess payments, for instance as a result of fraud, but generally do not include compensatory penalties assessed beyond actual harm (e.g., double and treble damages).[26]

Explicit Statutory Exceptions

There are a slew of statutory exemptions to the generally applicable miscellaneous receipts statute under federal law. DOJ for instance is explicitly authorized to administer the Assets Forfeiture Fund, which is funded through the proceeds of assets that are seized, forfeited, and detained through DOJ's and certain other agencies' law enforcement operations.[27] By statute, the DOJ may use these proceeds to cover necessary expenses associated with seizing, inventorying, storing, protecting, and selling such assets. This includes payments for forfeiture-related employee training, rewards to individuals who provide assistance

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[20] 31 U.S.C. §3302(b).

[21] *Id.*

[22] 2 Comp. Gen. 599, 600 (1923); see also U.S. Const. art. I, §9, cl. 7. To be clear, money from a particular source (e.g., a $5 billion civil penalty paid by BOA) that is remitted to the general fund is not *physically* segregated in a particular vault or account to be later used for a particular purpose. The individual accounts held by Treasury are for *accounting* purposes.

[23] GAO-06-382SP, 2 *Principles of Federal Appropriations Law*, Gov't Accountability Office 6-169.

[24] 5 Comp. Gen. 289, 290 (1925).

[25] GAO-B0302366, Jul. 12, 2004. GAO has held that this principle applies equally to nonappropriated funds, such as those in a revolving fund. 69 Comp. Gen. 260 (1990).

[26] GAO-B-281064, Feb. 14, 2000 ("Double and treble damages recovered pursuant to the False Claims Act are exemplary damages, not actual losses, 'because they are not limited to, but rather substantially exceed, the actual damages suffered by the United States.' United States ex rel. Graber v. City of New York, 8 F. Supp. 2d 343, 349 (S.D.N.Y. 1998). In the absence of statutory authority, agencies must deposit into the Treasury amounts recovered that are in the nature of penalties.").

[27] 28 U.S.C. §524(c).

with respect to certain federal civil and criminal violations, and costs associated with law enforcement operations jointly conducted with federal and state and/or local agencies.[28]

There also are a number of explicit statutory exceptions from the miscellaneous receipts statute relevant to the financial world. Pursuant to Section 1017 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),[29] the Consumer Financial Protection Bureau is authorized to remit civil penalties secured from violations of consumer financial protection laws into a Civil Penalty Fund. The Bureau is authorized to use the funds to pay victims of such violations, as well as for financial literacy and consumer education programs.[30]

Another provision of the Dodd-Frank Act establishes the Securities and Exchange Commission's Investor Protection Fund.[31] Pursuant to this provision, the SEC is authorized to pay whistleblowers who provide information that helps the SEC secure enforcement actions resulting in civil money penalties and certain other monetary relief of over $1 million.[32] Additionally, the SEC, under certain circumstances, is authorized by the Fair Funds provisions of Section 308(a) of the Sarbanes-Oxley Act of 2002 (SOX Act)[33] to provide remediation to harmed investors from civil money penalties and disgorgement obtained in response to violations of certain securities laws.

The FDIC also has statutory authority to administer claims on behalf of a failed depository institution that are outside the scope of the miscellaneous receipts statute. The FDIC administers a federal deposit insurance program, which includes overseeing a Deposit Insurance Fund, under the authority of the FDI Act.[34] The Deposit Insurance Fund is comprised of premiums assessed on the basis of the amount of insured deposits held by an institution.[35] If any institution with FDIC-insured deposits fails, the FDIC typically is appointed its receiver.[36] As receiver, the FDIC is charged with protecting federally insured deposits. To do so, the FDIC assumes "all the powers of the members or shareholders, the directors, and the officers of the institution." It also is empowered pay and settle claims against the failed bank. This often requires significant disbursements from the deposit insurance fund and results in the FDIC being the largest creditor of the failed institution.[37]

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[28] *Id.*

[29] 12 U.S.C. §5497(d).

[30] Pursuant to regulations issued by the Bureau, payments to victims harmed by behavior that has been subject to a civil penalty that go uncompensated (e.g., because the company or individual is too insolvent to be able to pay the entire assessed penalty) will be prioritized. Monies from the Civil Penalty Fund will only go to financial literacy and consumer education purposes if monies remain after eligible consumer victims have been fully compensated for their harms. 12 C.F.R. §1075.107. For more information on the CFPB's Civil Penalty Fund, see http://www.consumerfinance.gov/budget/civil-penalty-fund/.

[31] 15 U.S.C. §78u-6.

[32] *Id.* For more information on the SEC's Investor Protection Fund, see SEC Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2012, Nov. 2012, available at http://www.sec.gov/about/offices/owb/annual-report-2012.pdf.

[33] 15 U.S.C. §7246.

[34] 12 U.S.C. §§1811, *et seq.*

[35] 12 U.S.C. §1817(b). The Deposit Insurance Fund is a revolving fund that is excepted from the miscellaneous receipt statute as a result of its enabling statute, the FDI Act. GAO-06-382SP, 2 *Principles of Federal Appropriations Law*, Gov't Accountability Office 6-206, ch. 15, §C.

[36] 12 U.S.C. §1821(c).

[37] 12 U.S.C. §1821(d). For additional examples of statutory exceptions to the miscellaneous receipts statute, see Treasury Financial Manual, FAST Book II, Vol. 1, Supp. 1, available at http://www.fiscal.treasury.gov/fsreports/ref/fastBook/combine-fastbook-july-2014.pdf (listing General Fund Receipt Accounts for fines, penalties, and forfeitures, as well as certain Special Fund Receipt Accounts, along with their statutory authorization). In some instances, agencies also are statutorily authorized to retain reimbursements for previous payments, for example for the sale of products or services to the public or other agencies. 5 (continued...)

Payments That Are Not "for the Government"

Additionally, legal settlements can require private parties to distribute monetary relief directly to other private parties or to state or local governmental entities.[38] Such payments would not be "for the Government"[39] for purposes of the miscellaneous receipts statute, and thus would be wholly outside "the statutory mosaic Congress has enacted to implement its constitutional power of the purse."[40]

Distribution of BOA Settlement Relief

With these principles in mind, where did the various monetary relief provided by BOA go? The $5 billion FIRREA civil penalty paid to DOJ was remitted to the Treasury's General Fund in accordance with the miscellaneous receipts statute because there was no overriding statutory authorization to the contrary. Some of the $800 million cash payment settling claims associated with FHA and the $200 million payment to Ginnie Mae likely went to FHA's Capital Reserve Account and Ginnie Mae's Financing Account, respectively, as refunds for erroneous payments made as a result of BOA's alleged wrongdoing.[41] It is unclear where the $1.05 billion in payments to settle the several sealed lawsuits were distributed.

The $1.3 billion paid to the FDIC was distributed to the receiverships of 26 failed depository institutions pursuant to the FDIC's authority under the FDI Act[42] and to administer the Deposit Insurance Fund.[43] These statutory authorities establish exceptions to the generally applicable miscellaneous receipts statute.

(...continued)

Comp. Gen. 289 (1925) (With regard to "[t]he question as to whether moneys collected to reimburse the government for expenditures previously made ... it has been uniformly held that in the absence of an express provision in the statute to the contrary, such funds should be covered in as miscellaneous receipts.").

[38] GAO-06-382SP, 2 *Principles of Federal Appropriations Law,* Gov't Accountability Office 6-177- 6-183.

[39] 31 U.S.C. §3302(b)

[40] GAO-06-382SP, 2 *Principles of Federal Appropriations Law,* Gov't Accountability Office 6-177- 6-183 (quoting GAO Decision B-322531, at 4, Mar. 30, 2012). The agency must have the authority to provide such relief in a legal settlement. See GAO-B-210210, Sept. 14, 1983.

[41] BOA Legal Settlement at 6-7. It is not clear that all of these payments went to the respective FHA and Ginnie Mae accounts. Regarding the FHA claims, the Legal Settlement states: "Any amount that FHA receives will be deposited into the Federal Housing Administration's Capital Reserve Account." *Id.* Regarding the Ginnie Mae claims, the Legal Settlement states: "Any amount that Ginnie Mae receives will be deposited into the Government National Mortgage Association's Financing Account." Some of these proceeds may have gone to DOJ and the Department of Housing and Urban Development's Office of Inspector General as reimbursement for the provision of legal services and investigation costs associated with the settlement. See *Obama Administration Settlement With Bank of America Will Strengthen FHA Fund, Provide Billions in Consumer Relief*, Dept. of Hous. and Urban Dev. Press Release No. 14-101, Aug. 21, 2014, available at http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2014/HUDNo_14-101

[42] 12 U.S.C. §1821(d). It also could be argued that, because these funds were remitted to the FDIC in its private capacity as receiver in which the FDIC is acting pursuant to the authority of the failed depositories' officers, directors, and shareholders, these payments technically were not paid to "the Government" and thus are not subject to the miscellaneous receipts statute. Doe v. United States, 58 F.3d 494, 498 (9th Cir. 1995); In re Lopes, 211 B.R. 443, 447 n.3 (D.R.I. 1997). See also GAO-06-382SP, 2 *Principles of Federal Appropriations Law,* Gov't Accountability Office 15-207; Lapadula & Villani, Inc. v. United States, 563 F. Supp. 782, 785 (S.D.N.Y. 1983) (in holding that the FDIC is not entitled to absolute priority in an insolvency proceeding pursuant to 31 U.S.C. §191, the court states: "The FDIC's profits do not inure to the benefit of the United States and its losses are not borne by the United States. Thus, the public treasury will be unaffected by the success or failure in recovering the debts owed to it as successor in interest to the claims of the Franklin National Bank. It follows that the FDIC is not an integral part of the governmental mechanism but is rather a separate legal entity serving essentially a proprietary rather than a sovereign function.").

[43] 12 U.S.C. §1821(a). The Deposit Insurance Fund is a revolving fund that is excepted from the miscellaneous receipts statute as a result of its enabling statute, the FDI Act. GAO-06-382SP, 2 *Principles of Federal Appropriations Law,* Gov't Accountability (continued...)

According to the terms of the cease-and-desist orders between the SEC and BOA, the $245 million of civil penalties, disgorgement, and interest "may be distributed pursuant to the Fair Funds provisions of [the SOX Act]."[44] This means that the money potentially could be distributed to investors harmed by securities law violations. Any or all of the $245 million that are not distributed pursuant to the Fair Funds provisions will be remitted to the Treasury's general fund in accordance with the miscellaneous receipts statute.[45]

The remaining three categories of monetary relief that were part of the BOA Legal Settlement – payments to the states, consumer relief, and tax relief – appear to be outside the scope of the miscellaneous receipts statute because they are not "for the Government."

The $7 billion of consumer relief will be distributed to individual consumers and, potentially, certain private nonprofits and state or local governments or programs that provide community development and neighborhood revitalization services that are consistent with the Consumer Relief Terms.[46] This relief, therefore, does not go to the federal government and is outside the scope of the miscellaneous receipts statute. The $490 million tax relief has been deposited in an escrow account, in compliance with Department of Internal Revenue Services (IRS) regulation 26 C.F.R. §1.468B-1. That money will be distributed by an independent monitor to the IRS on behalf of any consumer who has federal tax liabilities as a result of receiving foreclosure- or mortgage-related relief under the Consumer Relief portion of the Legal Settlement.[47] Because these funds are held in trust within an escrow account for the benefit of consumers, they likely are not considered "for the Government," and therefore, are outside the scope of the miscellaneous receipts statute even though the payments will be made directly to a federal agency (the IRS).[48] To the extent that there are any funds remaining in the tax relief account after completely paying all valid tax relief payments or August 31, 2018, whichever is earlier,[49] 75% of those funds are to be distributed to state IOLTA organizations "or other statewide bar association affiliated intermediaries" that provide foreclosure- or community development-related legal services, and the remaining 25% are to be provided to Neighborworks America[50] for foreclosure, housing, and neighborhood stabilization purposes.[51]

(...continued)

Office 6-206, ch. 15, §C.

[44] Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Order and Civil Penalty, In the Matter of Bank of America, Corp., Sec. and Exchange Comm'n, Administrative Proceeding No. , Aug. 15, 2014, available at http://www.justice.gov/iso/opa/resources/479201482914154082478l.pdf and Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Order and Civil Penalty, In the Matter of Bank of America, Corp., Sec. and Exchange Comm'n Administrative Proceeding No. 3-16028, available at http://www.sec.gov/litigation/admin/2014/34-72888.pdf.

[45] See, *Report Pursuant to Section 308(c) of the Sarbanes-Oxley Act of 2002*, Sec. and Exchange Comm'n, available at https://www.sec.gov/news/studies/sox308creport.pdf.

[46] For a discussion of the Legal Settlement's "Community Development and Neighborhood Stabilization" terms, see *supra* n. 8.

[47] Bank of America Legal Settlement, at 8-9.

[48] GAO-B-303413, Nov. 8, 2004; 60 Comp Gen. 15, 26 (1980); 27 Comp. Gen. 641 (1948).

[49] The termination date also could be impacted by the implementation of tax relief similar to that provided by Mortgage Forgiveness Debt Relief Act of 2007, P.L. 1100-142. Bank of America Legal Settlement, Annex 3 - Tax Fund, at 3.

[50] For information about NeighborhoodWorks America, see http://www.neighborworks.org/About-Us.

[51] Bank of America Legal Settlement, Annex 3 - Tax Fund, at 3.

The payments to the state parties are governed by state laws and subject to specific instructions by each of the attorneys general of those respective states.[52]

[52] The scope of relevant state laws and authorities of state Attorneys General are outside the parameters of this memorandum.

Mr. CONYERS. I welcome the witnesses, and I am delighted to ask the first question to Mr. White to comment if he can on some of the remarks of Mr. Larkin that we have noted here, that the donations under settlement agreements are rife with opportunities for political cronyism, that settlement agreements circumvent the constitutional process for appropriating taxpayer dollars, and a few others. But were you disturbed or in less than full agreement with some of those remarks, Mr. White? Professor White?

Mr. WHITE. I am sorry. Would you mind repeating the question?

Mr. CONYERS. Well, I was just going over some of our first witness', Mr. Larkin, comments that I wanted to see if you were bothered by any of them as I was.

Mr. WHITE. Well, I certainly disagree. I guess on the constitutional point, I think where I could see a reasonable debate, to Mr. Frank's point, about particular cy pres remedies. But the general concept that in settling litigation you try and compensate the victims of the harm and you figure out the most effective and direct way of doing that, that is a completely uncontroversial principle. So I just think it is very farfetched to characterize the Justice Department's settlement here as appropriating taxpayer dollars.

And as far as money being directed to favor groups or to left wing groups, I mean, I just do not understand the factual basis for that when it is the banks. And I am curious to know why we did not ask the lawyers for the banks to come and tell us what they are going to do with the money because it is really up to them.

Mr. CONYERS. Are foreclosing banks, Professor White, usually represented by counsel? Can homeowners in a foreclosure generally afford counsel even?

Mr. WHITE. No, it is a serious problem, and there has been research about that as well. There is a study by the Brennan Institute for Justice on the number of homeowners who have legal counsel in foreclosure, and it is far too few obviously. It is also the case that there are many homeowners, like the couple in Delaware that was mentioned earlier, who try and deal with the banks without help from either housing counselors or legal aid lawyers.

And the evidence is very clear that you get a better result not just for the homeowner, but for the bank and the investor when you can either get an agreeable workout where the borrower pays off their loan perhaps at a lower interest rate or even where the homeowner has to surrender their house, sell it in a short sale, give a deed in lieu. All of those scenarios facilitated by those nonprofits is going to save hundreds of thousands for each homeowner and for the investors in that mortgage loan. So it is just an extremely effective way to use these funds to try and compensate the victims of the financial fraud.

Mr. CONYERS. Mr. Larkin, could I ask you about the Justice Department testimony that it is the banks, not the Department, who choose how to allocate their settlement donations? Do you think that is an accurate evaluation?

Mr. LARKIN. It may be accurate, but it is utterly immaterial. I say "may" because I do not have all of the agreements here. But I do know if you looked at Title 18, Section 2, you will see that it addresses this problem. It defines principals under the criminal law. If a particular individual takes an act himself, he or she is a

principal, and if it is a crime, that person is responsible. If an individual forces somebody else to do the act rather than do it him or herself, the first person is still responsible.

You cannot evade responsibility by getting somebody else to do your work for you. If you force somebody else to do it, you are responsible, and that is what is happening here. The Department is just telling private lawyers and private parties not to give all the money to the United States. They are telling them to give some of it to parties who Congress has not authorized to receive taxpayer funds. And it does not matter who that is. I do not care. No one is allowed to receive it unless Congress has authorized it.

Mr. CONYERS. Okay, thank you, sir. One more question, Mr. Larkin. You state that NeighborWorks of America funds a network of left wing community organizers in the mold of ACORN. I am a little offended by that. Do you know that NeighborWorks is chartered by Congress?

Mr. LARKIN. Sir, I think if you look you will see I did not say that. I quoted Investor's Business Daily as saying that. I did not say that. Investor's Business Daily made that statement, and I just quoted from what they said in my piece. And the problem there is even if it is not true that there is anything with ACORN, even if it is not true there is anything wrong with any of these organizations, they raise the appearance of impropriety. And Congress should be concerned about the appearance of impropriety as well as the fact of impropriety.

And it does not matter whether it is a Republican or Democratic Administration. No Administration should be free to give out money that the Congress has not authorized someone to receive.

Mr. CONYERS. Thank you very much. Let me ask Professor White about the research consistently demonstrating that foreclosure prevention counseling produces better results for homeowners who are facing foreclosure or in it, and are 70 percent more likely to remain current after receiving a modification in the National Foreclosure Mitigation Counseling Program, who are 3 times more likely than non-counseled homeowners to receive a loan modification. Does that comport with your experience?

Mr. WHITE. Yes, absolutely, and there is more than one study that has demonstrated that. And I think it is important to keep in mind that we still have over 2 million families who are either seriously delinquent or in foreclosure now, and there are a lot of preventable foreclosures that could be prevented.

And coming back to some points made to the Chair about the level of appropriation, I mean, there are plenty of reasons that Congress needs to be careful about how much is appropriated for various functions. But the fact is, in my view, both the legal service organizations representing homeowners and the housing counselors could effectively use more money than they are receiving from all sources, from private, State, Federal. They are underfunded.

Mr. CONYERS. Thank you so much. My time has expired. I thank you all.

Mr. MARINO. Ms. Mrose, you stated in your opening that you had a discussion with a Mr. Allison.

Ms. MROSE. That is correct.

Mr. MARINO. Was that a personal discussion that you had, or was that information relayed to you?

Ms. MROSE. That was a filmed interview that lasted an hour, and he released it for the public because we are going to use excerpts from it in the film.

Mr. MARINO. Okay. And I am assuming you are continuing to interview people. Have you interviewed other lending institutions to this point?

Ms. MROSE. I have not interviewed other lending institutions. I interviewed Peter Wallison and——

Mr. MARINO. And what does he do?

Ms. MROSE. Peter Wallison is at the American Enterprise Institute, and he was one of the commissioners of the Financial Crisis Inquiry Commission.

Mr. MARINO. Have you requested to interview people at lending institutions, and have they refused to talk to you?

Ms. MROSE. We are going to do that, and I am looking forward to that.

Mr. MARINO. First of all, before I ask another question, I would like to enter a document in the record. It is United States Environmental Protection Agency, and it is a memorandum concerning guidelines. And I just want to cite a section from here, and then the full document will be made a part of the record.

[The information referred to follows:]

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

DEC 15 2003

OFFICE OF
ENFORCEMENT AND
COMPLIANCE ASSURANCE

MEMORANDUM

SUBJECT: Guidance Concerning the Use of Third Parties in the Performance of Supplemental Environmental Projects (SEPs) and the Aggregation of SEP Funds

FROM: John Peter Suarez
Assistant Administrator

TO: Regional Counsels (Region I-X)
Regional Enforcement Managers (Region I-X)
Regional Media Division Directors (Region I-X)
Regional Enforcement Coordinators (Region I-X)

As part of my June 11, 2003 memorandum "Expanding the Use of Supplemental Environmental Projects," my office committed to issue guidance to assist Agency enforcement staff in encouraging and expanding the use of SEPs in enforcement settlements. Through settlements containing SEPs, we have the opportunity to not only bring regulated entities into compliance, but to secure public health and environmental benefits in addition to those achieved by compliance with applicable laws.

The June 11, 2003 memorandum also challenged enforcement staff to consider every opportunity to include more environmentally significant SEPs wherever possible. In response to that challenge, we have seen an increase in the number of innovative and creative SEP proposals put forward by the Regions. Two frequently asked questions concern the potential for aggregating funds to be used for SEPs into SEP "banks" or escrow accounts, and working with private entities to manage and/or implement SEPs. This memorandum provides guidance on how the Regions should approach these issues to comport with the Miscellaneous Receipts Act (MRA) and appropriations law. While the conditions of the MRA may limit our ability to aggregate SEP funds, this guidance provides suggestions for including SEPs in enforcement settlements in a manner that we believe does not trigger MRA or appropriations concerns. In addition, this guidance contains suggestions on the use of private organizations in implementing SEPs.

I. Aggregation of SEPs

A. Can SEPs Be Aggregated by Defendants/Respondents?

OECA has been been asked whether there are circumstances in which EPA can allow defendants/respondents to aggregate SEP funds. Where several defendants/respondents are settling separate cases for similar violations in the same general geographic area and at approximately the same time, the aggregation of SEPs could provide increased leverage and allow for projects with a greater environmental or public health benefit, and could provide an opportunity for defendants/respondents in smaller cases to take advantage of the SEP Policy.

Where Defendants/Respondents Are Jointly and Severally Liable for Performance of Consolidated SEP: The aggregation of SEPs may be acceptable if the settlements are crafted carefully. For instance, defendants/ respondents may propose pooling resources to hire a contractor to manage and/or implement a consolidated SEP. Such an approach could be acceptable if the respondents/defendants remain liable under the settlement agreement to perform the consolidated project in the same manner as they would under a typical settlement. Defendants/respondents are generally held accountable through the inclusion of stipulated penalties should the SEP not be completed as agreed upon.

Performance of Complementary, Segregable SEPs: Another approach that may be acceptable could be a situation where defendants/respondents in separate cases are interested in performing discrete and segregable tasks within a larger project. Such an approach would have to meet the following conditions to address any MRA concerns: (1) each discrete project must have a nexus to the violations at issue in the particular settlements and meets all conditions of the SEP Policy; (2) each discrete project must be itself worthwhile with environmental or public health benefits; and (3) the settlement must hold each defendant/respondent responsible for implementation and completion of a specific portion of the larger project. If the settlements are structured carefully, such an approach can result in a significant environmental or public health benefit that might otherwise be unavailable.

Example 1: A number of defendants/respondents in separate enforcement actions are interested in restoring and conserving a particular piece of property. One defendant/respondent could assume responsibility for acquiring the property and transferring ownership to a third party such as a local municipality or a land trust. A second defendant/respondent could assume responsibility for conducting a stream bank clean up and revegetation project on the property. A third defendant/respondent could take responsibility for re-establishing a fish ladder or other aquatic habitat.

Example 2: Defendants/respondents in separate settlements could develop and deliver compliance and training programs providing training and assistance to a regulated sector in a manner that reaches a significantly greater subset of that sector. For example, defendants/ respondents in separate hazardous waste enforcement cases could develop and present specialized training materials, videos, brochures, etc. relating to hazardous waste management in particular educational areas such as science labs and art schools. Because each compliance

promotion SEP would focus on a different educational area, the aggregation of SEPs in this manner could result in a much greater impact within the regulated community.

Other Considerations: While the aggregation of SEPs under these scenarios could be designed to avoid MRA concerns, in addition to the conditions set forth above, there are other practical limitations which need to be considered. For example, aggregation of SEPs in this manner may require that all settlements be completed at approximately the same time and that defendants/respondents in separate settlements are willing to cooperate with one another, either because they are all responsible for completion of the entire project or because one party's project is dependent on the timely performance by another party of its project, as in the first example above.

Consultation with ORE/SPLD: Regions are encouraged to consult with the Office of Regulatory Enforcement's (ORE) Special Litigation and Projects Division (SLPD)[1] early in the process when considering proposals by defendants/respondents to aggregate or coordinate SEPs in a manner described above.

B. Can EPA Aggregate SEP Funds?

OECA has had several inquiries into the feasibility of establishing SEP "banks" or accounts for pooling the funds applied towards SEPs. Specifically, the question is whether EPA may hold and manage, in one account, SEP funds from several settlements that would otherwise have been used by defendants/respondents for SEP projects in each individual enforcement settlement. While the aggregation of SEP funds may result in a SEP with greater public health or environmental benefits than several smaller funds, we have been advised by OGC that the MRA prohibits EPA from managing SEP funds.

The SEP Policy was written carefully to ensure compliance with the MRA. SEPs are not penalties; they are environmentally beneficial projects not otherwise required by law. The SEP Policy makes clear that defendants/respondents must perform a project and be responsible for its satisfactory completion rather than simply making a cash payment. The SEP policy is based on the premise that where a defendant/respondent performs an environmentally beneficial project, the Agency has the discretion to take the performance of the project into account as a mitigating factor when determining the amount of a penalty that the Agency will agree to as part of an overall settlement. A cash payment, such as a payment or donation to a third party or to a SEP "bank," where there is no further responsibility for the defendant/respondent to ensure that a specific project is completed, is prohibited because it could easily be construed as a diversion from the Treasury of penalties due and owing the government.

There are also constraints within appropriations law that restrict the Agency's ability to establish SEP accounts. Only Congress can appropriate funds for a federal agency. Establishing a SEP account where the Agency manages the funds and determines how they are to be spent

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[1] ORE's Multimedia Enforcement Division has been renamed the Special Litigation and Projects Division.

would amount to an augmentation of appropriations. The SEP Policy makes clear that EPA cannot manage or direct SEP funds. See *SEP Policy*, page 6 at paragraph 3.

II. Management of SEPs and SEP Funds by Private, Third Party Organizations

A. Can Defendants/Respondents Use Private, Third-Party Organizations to Manage SEPs and SEP Funds ?

We are aware that there are private organizations that are developing libraries of projects that might be suitable as SEPs. These groups hold themselves out as clearinghouses for environmental projects, and offer to obtain and manage funds, oversee the projects, and in some cases, charge a fee for their services. Private organizations that are developing libraries of projects and offering project and funds management, project implementation, and oversight services can play a valuable role in SEPs. It is permissible for defendants/respondents in enforcement actions to use a third party as a contractor or consultant to assist in the implementation of a SEP. See *SEP Policy*, Section F, page 17. An alleged violator could use a private organization to recommend SEPs to it during negotiations with the Agency, and then to manage a SEP, as long as (1) the defendant/respondent is obligated under the settlement document to complete the project satisfactorily, (2) the defendant/respondent fully expends the amount of funds agreed to be spent in performance of the SEP, and (3) the project meets all of the conditions and requirements of the SEP Policy. In other words, this approach is acceptable as long as the transactions with the defendants/respondents are structured such that the organizations are acting as contractual service providers to defendants/respondents as opposed to mere recipients of donated funds.

Cash Donations to Third Parties Are Not Permissible: Defendants/respondents may not simply make a cash payment to a third party conducting a project without retaining full responsibility for the implementation or completion of the project, as this appears to violate the MRA. In the context of an enforcement action, the Office of Legal Counsel (OLG) within the Department of Justice considered whether a defendant's donation of money to an organization designated by the Department of Interior (DOI) violated the MRA. In re: Steuart Transportation Company, 4 Op. Off. Legal Counsel 684 (1980), arose from a settlement of claims the United States and the Commonwealth of Virginia brought against an oil company for a spill in the Chesapeake Bay. Among other things, the federal government sought damages for the death of migratory waterfowl. The settlement terms required the oil company to resolve these claims by donating money to a waterfowl preservation organization designated by DOI and the Commonwealth of Virginia. One argument advanced to OLC by the proponents was that the proposed settlement did not violate the MRA because no money was received for the use of the United States within the meaning of the MRA since the funds did not go directly to DOI.

OLC concluded that the absence of a direct payment to DOI did not remove the transaction from the MRA. "[T]he fact that no cash actually touches the palm of a federal official is irrelevant for the purposes of [the MRA], ***if a federal agency could have accepted possession and retains the discretion to direct the use of the money***. The doctrine of

constructive receipt will ignore the form of the transaction in order to get to the substance." In re: Steuart at 688 (emphasis added).

B. Can EPA Use Private, Third-Party Organizations to Manage SEPs and SEP Funds?

Several private organizations have proposed working with EPA to maintain SEP libraries and provide project implementation and/or management services. This raises some difficult legal issues. First, a close working relationship with such organizations could create the appearance that EPA is using the organization as a means to indirectly manage or direct SEP funds. Second, there are ethical restrictions on endorsing or otherwise providing private organizations with unfair competitive advantages in selling their SEP management and implementation services to defendants/respondents. Based on consultation with OGC, we have concluded that it would be improper for EPA to enter into an agreement with such organizations at either the Headquarters or Regional level.

OGC has advised that Regions could make a list of such organizations available to defendants/respondents as long as the Region does not promote one group over another, has an open and fair process for adding other qualified groups to the list, and maintains a disclaimer making it clear that the list does not constitute an endorsement or recommendation of any of the listed entities.

If you have any questions about this memorandum, please contact Susan O'Keefe at (202) 564-4021, or either Beth Cavalier or Melissa Raack of her staff. Beth can be reached at (202) 564-3271; Melissa can be reached at (202) 564-7039.

cc: OECA Office Directors
ORE and OC Division Directors
SEP Coordinators
DOJ, Environmental Enforcement Section, Projects Group

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Mr. MARINO. "Cash donations to third parties are not permissible. Defendants/respondents may not simply make a cash payment to third party conducting a project without retaining full responsibility for the implementation or completion of the project as this appears to violate the MRA," and that is the Miscellaneous Relief Act.

Mr. Frank, what is wrong with having guidelines to explain how taxpayer dollars, or fines, or restitution should be appropriated?

Mr. FRANK. Well, the guidelines should be implemented by Congress given that the executive branch does not have the authority to allocate money. But I think guidelines are a good thing and are a good way to avoid the potential conflicts of interest when the executive branch bleeds into the separation of powers by structuring settlements this way.

Mr. MARINO. Mr. Conyers?

Mr. CONYERS. Would you yield? Thank you, sir. Mr. Frank, in your written testimony, sir, you describe the Justice Department as having unfettered power to structure settlements. Were the settling banks represented by counsel in those settlement negotiations? Were the banks under any coercion to settle as opposed to litigating? And could a Federal court award consumer relief provisions had these cases been litigated? What are your thoughts about that, sir?

Mr. FRANK. Those are multiple issues.

Mr. CONYERS. Yes.

Mr. FRANK. But certainly the defendants were represented at the settlement table, and it is not clear that they did not get one over on the Justice Department here by getting the illusion of $7 billion that might end up costing them $2 or $3 billion. With respect to whether this could happen in a court, I do not believe FIRREA, the underlying statute where the allocations were made here, would authorize this sort of particular relief if it was litigated to judgment, whether a court would approve a settlement involving these third party transactions.

Well, what district courts do is not always what is particularly legal, especially in the settlement context where they are trying to get cases off of their dockets. And that is the experience I have had in the civil context.

Mr. CONYERS. Let me ask you, did the Justice Department settlements with Citigroup of Bank of America involve, in your view, class action lawsuits in any fashion?

Mr. FRANK. No, those were not class action lawsuits, but the underlying principles are the same principles.

Mr. CONYERS. Good. Thank you, Mr. Chairman. I yield back any time I may have.

Mr. MARINO. As I said earlier, we are pressed for time to get out of this room. I do want to thank all of you for being here and testifying. I wish we could have another hour or two of hearing from you. Maybe in the future we will have that opportunity. And this concludes today's hearing, and, again, thank you for attending.

And without objection, all Members will have 5 legislative days to submit additional written questions to the witnesses or additional materials for the record.

This hearing is adjourned.

[Whereupon, at 12:37 p.m., the Subcommittee was adjourned.]

APPENDIX

Material Submitted for the Hearing Record

Response to Questions for the Record from Geoffrey Graber, Deputy Associate Attorney General and Director, RMBS Working Group of the Financial Fraud Enforcement Task Force, U.S. Department of Justice, Washington, DC

Questions for the Record
Geoffrey Graber
Deputy Associate Attorney General
And
Director, RMBS Working Group of the Financial Fraud Enforcement Task Force
"Consumer Shortchanged?
Oversight of the Justice Department's Mortgage Lending Settlements"
Committee on the Judiciary
Subcommittee on Regulator Reform, Commercial and Antitrust Law
U.S. House of Representatives
February 12, 2015

Questions Posed by Representative Marino

1. **How much relief in the Citi and Bank of America settlements went to mortgage investors? Aren't mortgage backed securities sold to investors? If so, wouldn't fraud involving those products have heavily and adversely affected the investors suggesting that relief should at least have been considered? Please cite any provisions or instances where relief is set to go directly to investors under the Citi or Bank of America settlements.**

Response:

In addition to providing an unprecedented level of accountability and historic relief to American homeowners, the settlements with JP Morgan, Citigroup and Bank of America also provided relief to Residential Mortgage-Backed Security (RMBS) investors. In each of the Citigroup and Bank of America settlements, when providing mortgage modification relief to homeowner's whose loan is in a securitized pool, all such activity must be permitted by the relevant investor and/or trustee and permitted pursuant to the applicable underlying mortgage investor documentation. Such documentation generally requires that modifications only be performed when economically beneficial to the investor, thereby providing the investors with relief. In addition, in both settlements, over $1.2 billion was paid to the Federal Deposit Insurance Corporation (FDIC), acting as the receiver for federally-insured banks that had invested in RMBS. Both settlements also provided for the payment of hundreds of millions of dollars to several states, which in turn paid out funds to investors such as state pension funds.

2. **NPR reports that "at the height of the financial crisis" the government pushed J.P. Morgan CEO Jamie Dimon "hard" to acquire Bear Stearns. Prominent investor Warren Buffet [said] ". . . Dimon helped the entire economy with what he did." Ironically, the government then held J.P. Morgan liable for Bear Stearns' alleged prior bad acts.**

A. **On an investor call to discuss the bank's $13 billion settlement, Dimon said, "a Bear Stearns deal would not happen again that way. We simply wouldn't undertake it . . . . We did it because we were asked to and we never expected this kind of stuff to happen." (Emphasis added) What is DOJ going to do to cure the perception that it punishes good Samaritans?**

B. **NPR reports that former "Financial Services Committee Chairman Barney Frank has said companies should not be punished for deals the government pressures them into." Do you agree?**

Response:

The settlement with JP Morgan covered conduct related to JP Morgan itself, as well as conduct related to Washington Mutual and Bear Stearns. JPMorgan acquired the liabilities of Bear Stearns and understood it was doing so. Nevertheless, the government was aware of the unique circumstances that surrounded JP Morgan's purchase of other banks, including Bear Stearns, during the financial crisis. The government took those circumstances into account when crafting the settlement.

Questions Posed by Representative Conyers and Representative Johnson

3. What is the Department's view on the significance of the statement of facts that each bank agreed to as part of the settlement?

Response:

The statements of fact – which are, at base, acknowledgements by the banks of key evidence underlying the government's allegations of wrongdoing – have served to provide accountability and transparency. The statements have provided accountability because they required the settling institutions to admit their misconduct to their employees, their shareholders and the American people. The statements also have provided transparency, insofar as they outlined for the public the facts uncovered by the government's investigations.

4. You refer in your testimony to the Residential Mortgage-Backed Securities Working Group.

A. Were any nongovernmental entities a member of this Working Group?

B. Why was the Working Group focused on holding "accountable those who broke the law"?

Response:

The RMBS Working Group is comprised of several federal agencies, U.S. Attorneys, and state attorneys general offices. The Working Group does not include any non-governmental entities as members. The primary focus of the Working Group is to hold accountable those who broke the law. This is consistent with the President's call in the 2012 State of the Union Address for a targeted group to "hold accountable those who broke the law, speed assistance to homeowners, and help turn the page on an era of recklessness that hurt so many Americans." This focus is also consistent with the Department of Justice's (the Department) primary mission to enforce the Nation's laws, and to hold those who violate the law accountable.

5. How do the consumer relief portions of these settlements differ from the National Mortgage Settlement? Do these differences benefit consumers?

Response:

The consumer relief provisions in the RMBS settlements differ from the National Mortgage Settlement in a variety of ways. In general, the National Mortgage Settlement focused primarily on modifications of existing mortgages held by the financial institutions that participated in the

resolution. These modifications included principal reduction, loan forgiveness on second liens, and short sales. The consumer relief provisions in the RMBS settlements go beyond these types of modifications and provide greater levels of relief to the homeowners. For example, in the Citigroup and Bank of America settlements, the banks only receive credit for loan modifications that at least bring underwater mortgages back to 100% loan-to-value. Moreover, unlike the National Mortgage Settlement, the RMBS resolutions require that the banks provide at least half of the loan forgiveness in hardest hit communities and the banks generally receive greater credit for that relief.

6. In his written testimony, Mr. Larkin argues that the settlement agreements "circumvent the constitutional process for appropriating taxpayer dollars." Do any of the funds used in these settlement agreements derive from taxes? Do the settlements have any effect on the tax liabilities of the settling banks?

Response:

The RMBS settlements do not divert any taxes or other public monies. A significant component of each of the RMBS settlements consists of a FIRREA penalty. These penalties were paid by the settling banks and deposited into the General Fund of the United States Treasury. Pursuant to its statutory authority to settle cases in the best interest of the United States, the Department also agreed with the settling banks that it was appropriate to include consumer relief provisions in the settlement agreements. However, these consumer relief provisions will not be funded through public monies. Instead, these are private funds – totally separate from the FIRREA penalties and payments to our federal and state partners – provided and disbursed by the settling banks as part of the settlement agreements. At no point will the Department receive these funds; rather, the funds go directly from the settling banks to the recipients, to assist consumers in the housing market, including struggling homeowners who have suffered as a result of the collapse of that market.

7. In his written testimony, Mr. Frank argues that the settlement agreements represent *cy pres* settlements, which carry a risk of conflict of interest. Please respond to this statement.

Response:

The Department does not view the RMBS resolutions as "cy pres settlements." As noted above, the Department has clear statutory authority to compromise claims on behalf of the United States. Settlements entered into by the Department frequently include a penalty amount as well as some form of restitution to those who suffered harm as a result of the misconduct. That is precisely what the parties agreed to in these settlements.

8. Have there been any allegations of unscrupulous activity by servicers in administering voluntary mortgage modifications under the Home Affordable Modification Program (HAMP)?

Response:

The Department cannot comment on whether there are any ongoing investigations of servicers that administer voluntary mortgage modifications under the Home Affordable Modification Program (HAMP).

9. Christy Romero, Special Inspector General for TARP (SIGTARP), argued that the investigation of SunTrust's activity involving voluntary mortgage modification activities under HAMP revealed that many of the homeowners "would have been exponentially better off having never applied through the bank in the first place," referring to SunTrust's negligence in administering HAMP as "appalling, miserable, inexcusable, and repulsive." Please discuss these activities and how this investigation shaped the consumer-relief provisions of the Bank of America, Citigroup, and JPMorgan settlements.

Response:

The Department is aware of the investigation, which involved a component of the Department, but is not in the position to comment further on the investigation or activities referenced by Christy Romero, Special Inspector General for Troubled Asset Relief Program (TARP), related to HAMP administration. We can represent unequivocally that neither had anything to do with the formulation of the consumer relief provisions of the Bank of America, Citigroup, and JP Morgan settlements.

10. In his written testimony, Mr. Larkin argues that the "Justice Department lacks the statutory authority to hand over government funds to parties of its own choosing." Please discuss the Justice Departments' authority to craft settlement agreements.

Response:

Please refer to the response above at Question 4.

Response to Questions for the Record from Alan M. White, Professor of Law, CUNY School of Law, New York, NY

Response to Additional Questions Submitted for the Record
Professor Alan M. White

Questions submitted for the Record from Subcommittee Chairman Marino

1. I disagree with the premise of these questions. Congress has authorized the Justice Department to enforce violations of the securities, consumer and banking fraud laws. In particular, Congress has provided in those laws for civil enforcement actions in which the Executive branch may seek fines, damages and compensation to the victims of the fraud. BankofAmerica and Citigroup, and their various corporate predecessors, sold unsustainable and dangerous mortgage products, for example, the so-called exploding ARM favored by Countrywide Mortgage, which led to a foreclosure crisis resulting so far in the loss of more than 7 million homes. The investment banking arms of the same banks told securities investors that the mortgage loans were being underwritten prudently, while knowing very well that specific representations about underwriting were false. As a result of the securities fraud, the world economy experienced losses in the trillions of dollars. In addition, FNMA and Freddie Mac and the F.H.A. insurance fund suffered losses to the value of the mortgages they purchased and were sold mortgages at greater risk of default and foreclosure than represented.

   It would certainly be legitimate to question whether the settlements of these claims adequately and fully compensate the massive numbers of victims of the subprime crisis of 2008. One cannot, however, question the fact that federal laws were violated, that the enforcement of those laws includes punishing the wrongdoers and compensating the victims, and that that job belongs to the executive, not the legislative branch.

   In any financial fraud case, the securities laws permit the courts to award fines payable to the US Treasury and to award disgorgement to the victims of the fraud. There would be nothing unusual about a court ordering BofA or Citi to pay money into a compensation fund to compensate homeowners and mortgage securities investors. Nor would it be remarkable for a court, given the massive and widespread impact of these frauds, to order some of the victim compensation to be paid to organizations whose mission is precisely to assist victims of the foreclosure crisis. Moreover, housing counseling is an effective means to mitigate further losses on mortgages that are still outstanding and held or insured by the GSE's or F.H.A.

   The task of identifying every individual victim of the foreclosure crisis would be herculean. In fact, the federal banking regulators, in their separate settlements with the major banks based on servicing misconduct in foreclosing homes after 2008, tried to do just that and failed abysmally. Billions of dollars were spent in a futile effort to determine which individual homeowners were wrongfully

foreclosed or were entitled to have their foreclosures halted. That money went to consulting firms and never benefitted the homeowners who were the intended beneficiaries.

Faced with these choices a court, or the Justice Department in a settlement, could reasonably decide that victims of financial fraud will be more efficiently compensated by requiring the defendant banks to remedy the frauds by paying funds to improve and expand counseling and legal aid for foreclosure victims.

2. The statement that grants to "HUD-approved housing counseling agencies" are almost sure to include grants to the National Council of La Raza and Neighborworks America is incorrect. There are hundreds of agencies from which the banks can select. Many large agencies receive substantial grants other than the two mentioned in this question. For example the National Foundation for Credit Counseling, Inc. received $1.3 million from HUD this year. We will find out soon enough how the banks will choose to distribute the funds, and to what groups. The only "restriction" on the funds created by the Justice Department is the restriction that the funded groups actually provide direct and relevant aid to victims of the financial fraud that was the subject of the enforcement actions.

3. The two-for-one credit may provide some modest incentive for the banks to direct funds to housing counselors and legal aid agencies, but the banks are likely to see debt write-downs as much cheaper to achieve the settlement compensation targets. The charges taken by the banks for these settlements reflect assumptions that very little settlement credit will be earned by actual cash outlays.

4. There is a mechanism in the settlements to insure that funds are spent appropriately: the settlement monitors. The committee might inquire with the monitors for the two settlements, perhaps more usefully after the funded groups are actually known, to see how spending will be monitored. The committee might also request the banks to provide sample contract provisions it will use with the funded groups. My testimony was based on the experience with previous state law enforcement settlements that provided for similar victim compensation arrangements. It has been the norm to provide funding for housing counselors and legal aid for homeowners through contracts with enforceable commitments to use the funds appropriately, rather than simply by writing checks. If the banks make payments to housing counselors or legal aid agencies without appropriate contractual requirements for the use of the funds, I would expect the monitor to take issue with giving credit to the banks for such payments.

Questions submitted by Representative John Conyers, Jr. and Representative Henry Johnson, Jr.:

1. Funds dedicated to neighborhood stabilization and community revitalization have been applied to remediating the negative community impacts of the foreclosure crisis. The primary use of the funds has been to purchase and rehabilitate foreclosed and abandoned homes and demolished properties. Foreclosures have not been distributed evenly throughout the country; they are concentrated in heavily impacted cities and neighborhoods, for example Buffalo New York and the central valley in California. The settlement provisions concerning abandoned homes incentivize the banks to release mortgages or donate foreclosed abandoned properties to local land banks and to fund nonprofits for demolition, maintenance and rehabilitation of abandoned homes. These activities help to remedy the community harms resulting directly from the banks' banking and securities fraud leading to the foreclosure crisis, by getting abandoned foreclosed houses back into productive use.

2. The HAMP program to incentivize mortgage servicers to negotiate alternatives to foreclosure sales has been only a partial success. Fewer than 2 million mortgages have been successfully worked out, compared with initial goals of 3 to 5 million. The program was premised on the idea that providing incentive payments to mortgage servicers would encourage them to incur the transaction costs necessary to make net-present-value-positive loan modifications, in other words, to restructure mortgage loans with lower interest rates, principal reduction or term extension, to realize a greater net return than would result from a foreclosure sale.

   The record of bank compliance with HAMP guidelines has been poor. Residential mortgage servicing is now heavily concentrated in the largest banks. Their continuing failure to effectively manage defaulted mortgages has been widely documented in academic research and regulatory oversight at the federal and state levels. There is a continuing need to improve the performance of the banks in their role as mortgage servicers.

3. The statement that donations under the settlement agreement are rife with opportunities for political cronyism is without basis in fact. There is simply no evidence that any elected official or political appointee will have any ability to determine the amounts or recipients of grants made by the banks under the settlement agreement.

4. The bank settlements incentivize loan modifications by giving credit towards settlement targets for principal forgiveness and cancellation of underwater junior liens. Principal reduction allows a mortgage debt to be realigned with

a reduced home value, and greatly improves the likelihood that the mortgage will be repaid and the homeowners will retain their home. OCC mortgage metrics reports have consistently shown that principal reduction increases the reperformance rate of modified mortgages and thus reduces redefaults and losses to banks, investors, and the GSE's.

5. The bank settlement agreements do not allocate any taxpayer funds. I am not able to respond to the question regarding the effect of the settlements on bank tax liabilities. In any event, the remedial payments under these settlements are no different than remedial payments made under a variety of other federal enforcement agency actions, such as the Bernie Madoff securities fraud settlements, lending discrimination settlements,

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February 20, 2015

The Honorable Tom Marino
410 Cannon House Office Building
Washington, DC 20515

The Honorable Hank Johnson, Jr.
2240 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Marino and Ranking Member Johnson:

Thank you for the opportunity to clarify some inaccuracies about the National Council of La Raza (NCLR) and our work that were raised in last week's hearing of the House Judiciary Subcommittee on Regulatory Reform, Commercial and Antitrust Law, "Consumers Shortchanged? Oversight of the Justice Department's Mortgage Lending Settlements."

First, the testimony of Cornelia Mrose, CEO of Compass Films of New York, LLC, referred to the activities of NCLR's "Political Action Committee." NCLR does not have and has never had a political action committee in the 47 years since our founding.

Second, a member of the committee conflated two separate NCLR statements on two distinct issues with regard to housing counseling. In 2011, NCLR was part of a diverse coalition—including the NAACP, the National Coalition for Asian Pacific American Community Development, and the National Urban League—that criticized the significant budget cuts in housing counseling programs made by the U.S. Department of Housing and Urban Development (HUD). These organizations, like NCLR, are among the 27 organizations such as Catholic Charities USA and the National Council on Aging that are certified as housing intermediaries by HUD.

The coalition came together because of the proven worth of, and need for, housing counseling to protect homeowners, especially those in communities of color who were hit particularly hard by the housing crisis. It is for this reason that NCLR applauds efforts to include housing counseling funds in mortgage settlements. As we noted in our letter dated February 11, 2015, housing counseling is one of the most effective and cost-effective ways of helping millions of families facing foreclosure stay in their homes. It is therefore entirely appropriate that institutions legally mandated to provide restitution to those they harmed would turn to housing counselors.

Third, several members of the committee expressed concern that NCLR will use funds designated for housing counseling for other advocacy work. This concern is completely unfounded. As a certified HUD housing counseling intermediary, we must comply with strict standards regulating the use of such funds. All applicants for funding must comply with the provisions of Section 319 of Public Law 101–121, 31 U.S.C. 1352 (the Byrd Amendment) and 24 CFR Part 87, which prohibit recipients of federal contracts, grants, or loans from using appropriated funds for lobbying the executive or legislative branches of the federal government.

In addition, applicants must disclose, using Standard Form LLL (SFLLL), Disclosure of Lobbying Activities, any funds, other than federally appropriated funds, that will be or have been used to influence federal employees, members of Congress, or congressional staff regarding specific grants or contracts. Applicants must submit SFLLL if they have used or intend to use nonfederal funds for lobbying activities. In fact, regardless of source, none of the funding for our housing programs is either fungible or discretionary since all of it is raised specifically to do programmatic housing work.

Again, we appreciate the chance to correct the record. For your reference, I have included excerpts from the book *Forces for Good: The Six Practices of High-Impact Nonprofits*, describing NCLR as one of the best nonprofits in the nation. If you have any questions or need further information, please do not hesitate to contact Lindsay Daniels, Manager, Wealth-Building Initiative, at (202) 776-1704 or ldaniels@nclr.org.

Sincerely,

Lautaro "Lot" Diaz
Vice President
Housing and Community Development

cc: Congressman Jeb Hensarling
Congressman Bob Goodlatte

Forces for Good

The Six Practices of High-Impact Nonprofits

Leslie R. Crutchfield and

Heather McLeod Grant

Foreword by Steve Case

A project of the Center for the Advancement of Social Entrepreneurship at Duke University's Fuqua School of Business

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Introduction

During the last several decades, a new cadre of entrepreneurial nonprofits has created extraordinary levels of social impact. These pioneering "change makers" are the vanguard of a growing civic sector—a segment of the U.S. economy now valued at more than $1 trillion. Operating at the interstices of government and the market—a broad and ill-defined "grey space"—these organizations play an increasingly important role in shaping our world.

That's why we set out four years ago to research and write about some of the most successful nonprofits of our era. We surveyed thousands of nonprofit CEOs and conducted more than sixty interviews just to select the twelve exemplary organizations featured in this book. (See Table I.1.)

Then we spent two years studying these organizations intensively and uncovering their secrets to success. *We wanted to know what enabled them to have such high levels of impact.* What we learned along the way truly surprised us.

In the course of our research, we discovered six practices that help great nonprofits achieve significant results. Our findings were nothing like the conventional wisdom about nonprofit management we had read before. You'll learn in this book—just as we learned—that we need new frameworks for understanding what makes great nonprofits great, and new ways of thinking about creating social change. Fortunately, these twelve organizations can help show us the way.

TABLE I.1. TWELVE EXEMPLARY ORGANIZATIONS.

Organization	*Issue Area*
America's Second Harvest	Hunger relief
Center on Budget and Policy Priorities	Federal and state budget analysis
City Year	National service, youth leadership
Environmental Defense	Environment
Exploratorium	Museums, science education
Habitat for Humanity	Housing
The Heritage Foundation	Conservative public policy
National Council of La Raza	Hispanic interests
Self-Help	Housing and economic development
Share Our Strength	Hunger relief
Teach For America	Education reform
YouthBuild USA	Youth leadership, housing, job training

WHY THIS BOOK, AND WHY NOW?

Our research on high-impact nonprofits arrives at a key inflection point in the development of the global social sector. Indeed, we believe the rise of this sector is one of the great untold stories of our time.

In the United States alone, 1.5 million nonprofits now account for more than $1 trillion in revenues annually of the nation's economy.[1] During the past fifteen years, nonprofits grew faster than the overall economy, with thirty thousand new organizations created each year. In fact, nonprofits are now the third-largest industry in the United States, behind retail and wholesale trade, but ahead of construction, banking, and telecommunications.[2] Although terminology varies—the industry is alternately called civil society, the citizen sector, the social sector, the nonprofit sector, or the third sector—its importance is undeniable.

Internationally, similar trends are reflected in the growth of a global civil society. "Few developments on the global scene over the past three decades have been as momentous as the recent upsurge

REVENUE/EXPENSES

Heritage reported total revenues of approximately $40 million in 2005, over half of which came from individual contributors. Heritage's initial funding came from Joseph Coors, owner of the Coors Brewing Company. Other wealthy philanthropists have been generous Heritage donors as well. With 275,000 individual donors, however, Heritage enjoys the broadest base of support of all think tanks. Heritage uses mail, telemarketing, one-on-one meetings, planned giving, grant proposals, publication sales, and Internet appeals to raise funds. In 2005, Heritage reported total expenses of approximately $36.5 million, of which about $30 million were devoted to program expenses.

HISTORY

Heritage was founded in 1973, with conservative activist Paul Weyrich as its first leader. Since 1974, Heritage's president has been Edwin J. Feulner, PhD, former staff director of the House Republican Study Committee and a former staff assistant to Congressman Phil Crane (R-IL). Under Feulner's leadership, Heritage has come to be known for the wide-ranging and influential nature of its work. Unlike traditional think tanks, which tend to house scholars and politicians-in-exile who produce large books, Heritage tends to employ public policy analysts who produce comparatively shorter policy papers intended to pass what Heritage calls "the briefcase test" for busy politicians to read on the run. Heritage also pioneered the "marketing" of policy ideas through astute packaging and public relations, now a staple feature of Washington think-tank activity.

NATIONAL COUNCIL OF LA RAZA

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PURPOSE

The National Council of La Raza ("NCLR")—the largest national Hispanic civil rights and advocacy organization in the United States—works to improve opportunities for Hispanic Americans.

PROGRAMS

NCLR works through two primary, complementary approaches. First, NCLR provides organizational assistance in management, governance, program operations, and resource development to Hispanic community-based organizations nationwide, especially those that serve low-income and disadvantaged Hispanics. Second, NCLR conducts applied research, policy analysis, and advocacy, increasing policymaker and public understanding of Hispanic needs and encouraging the adoption of programs and policies that equitably serve Hispanics. NCLR strengthens these efforts with public information, media activities, and collaboration.

PARTICIPANTS AND/OR RECIPIENTS

NCLR serves all Hispanic subgroups in all regions of the country and has operations in Atlanta, Chicago, Los Angeles, New York, Phoenix, Sacramento, San Antonio, and San Juan, Puerto Rico. Through its network of nearly three hundred affiliated community-based organizations, NCLR reaches millions of Hispanics each year in forty-one states, Puerto Rico, and the District of Columbia.

IMPACT

NCLR conducts research, policy analysis, and advocacy, and provides capacity-building assistance to its affiliates working at the state and local levels. NCLR shaped the Immigration Reform and Control Act of 1986, which legalized the status of nearly three million previously undocumented workers; the Immigration Act of 1990; and legislation over the 1997–2002 period restoring benefits to millions of low-income legal immigrants. The organization helped preserve and expand the Voting Rights Act in 1992, and again in 2006; catalyzed a 1990 Executive Order on Hispanic Educational Excellence, which helped reduce Latino underrepresentation in college preparation; and helped shape the expansion of the Earned Income Tax Credit in 1992 and the establishment of a partially refundable child tax credit in 2001. NCLR and its network of affiliates operate the largest Latino-focused home ownership network in the country. The organization's subsidiary, the Raza Development Fund, is the largest Hispanic community development bank in the United

States. NCLR has helped start fifty charter and alternative schools. NCLR sponsors the American Latino Media Arts (ALMA) Awards, the only prime-time network television awards recognizing Hispanics' contributions in film, television, and other media.

ORGANIZATION

NCLR is governed by a board of directors, which includes thirty members who are representative of all geographical regions of the United States and all Hispanic subgroups. The organization also receives guidance from a corporate board of advisers, which includes senior executives from twenty-eight major corporations and their liaison staff; and the affiliate council, which includes twelve affiliated community-based organization executive directors and other senior executive staff members, elected from all regions of the country.

REVENUE/EXPENSES

In 2005, NCLR reported total consolidated revenues of approximately $31 million. General support from individual and affiliate organization members, special events registrations and sponsorships, and corporate donors and foundations totaled $21.2 million; $4.1 million came from government entities. NCLR's balance sheet includes assets and liabilities of the Raza Development Fund, a subsidiary corporation; and the assets, liabilities, revenues, and expenses of the Strategic Investment Fund for La Raza, a support corporation created to house NCLR's endowment, which is projected to grow to $30 million by 2008. In 2005, NCLR reported total expenses of approximately $28.5 million, of which investments in program services totaled $21.8 million, or 89 percent, excluding fundraising. The two biggest program activity expenses were education (34 percent) and community development (21 percent).

HISTORY

Originally the Southwest Council of La Raza, NCLR was founded in 1968 by three key individuals—Herman Gallegos, Julian Samora, and Ernesto Galarza—in the wake of the civil rights movement, to

provide grassroots programs and services to a growing Latino community and to advocate for their civil rights. NCLR helped launch and support seven barrio organizations in three southwestern states as its first "affiliates." In 1974, Raul Yzaguirre joined NCLR as chief executive. In the late 1970s, NCLR formally revised its mission to serve all Hispanics—not just Mexican Americans—and established a policy analysis and advocacy capacity to complement its program work. Yzaguirre left NCLR in 2004, and was replaced by Janet Murguia, who had joined NCLR earlier that year as chief operating officer.

SELF-HELP

Self-Help (www.self-help.org; www.responsiblelending.org)
P.O. Box 3619
Durham, NC 27702
Telephone: 919-956-4400, 800-476-7428

PURPOSE

Self-Help's work is based on the belief that ownership allows people to improve their economic position. Owning assets, such as a home, can enable a family to send a child to college, start a business, or weather a financial crisis. In its work as a direct lender, Self-Help acts as a laboratory for economic development—experimenting to find out what works and advocating for change in the public and private sectors.

PROGRAMS

Self-Help has several major programs to serve the organization's purpose. The Center for Community Self-Help is a nonprofit 501(c)(3) organization that develops and coordinates Self-Help's programs, raises resources, and advocates for economic opportunity. The Self-Help Credit Union is a federally insured, state-chartered credit union that raises market rate deposits from members to make commercial and home loans. Its members include nonprofit and religious organizations and other socially responsible individuals and institutions. The Self-Help Ventures Fund is a nonprofit 501(c)(3) organization that concentrates its lending on higher-risk, unconventional, and

AMI ASSOCIATION OF MORTGAGE INVESTORS

STATEMENT

ON BEHALF OF

THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

JUDICIARY COMMITTEE SUBCOMMITTEE ON

REGULATORY REFORM, COMMERCIAL, AND ANTITRUST LAW

HEARING: HEARING: CONSUMERS SHORTCHANGED? OVERSIGHT OF THE JUSTICE DEPARTMENT'S MORTGAGE LENDING SETTLEMENTS

FEBRUARY 12, 2015

by CHRIS J. KATOPIS

EXECUTIVE DIRECTOR

Introduction

Chairman Marino, Ranking Member Johnson, and distinguished members of the Subcommittee, thank you for the opportunity for the Association of Mortgage Investors (AMI) to submit the enclosed written statement for the record. Our hearing statement will focus on the issues and concepts regarding the recent U.S. Department of Justice ("DoJ") bank-servicer securities settlements, the resulting impact on private capital in the housing finance system, the concerns of investors surrounding the flawed remedies, and the impact on the retirement security of your constituents across the country.

We commend the House Judiciary Committee's ongoing oversight and leadership in this arena. The recent settlements with major bank-servicers will negatively impact Residential Mortgage-Backed Securities (RMBS) certificate holders; lack transparency for stakeholders and the public-at-large; and, fail to provide stakeholders fair and reasonable representation throughout the process.[1] Further, these ill-conceived settlements are deeply flawed, as well as, chill further private capital investment in the U.S. mortgage market, limit mortgage affordability and availability, especially for first-time home owners. Simply, the Department of Justice is threatening the American Dream of a 30-year fixed mortgage.

Background

A key goal of the system is the flow of mortgage credit and capital from investors to the borrower and then back again. At its essence, the present situation limits the availability of housing credit and the reach of the American Dream of home ownership. In response, AMI would like to discuss how the flawed recent settlements impact investors and stakeholders in the U.S. mortgage market, including seniors, public pensioners, and 401K retirement savers.[2]

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[1] *BofA in Talks to Pay At Least $12 Billion to Settle Probes: At Least $5 Billion Expected to Go to Consumer Relief*, WALL STREET JOURNAL (June 5, 2014), *available at* http://online.wsj.com/articles/bofa-in-talks-to-pay-at-least-12-billion-to-settle-probes-1402006948;

[2] *Why You may be Paying for Someone else's Mortgage Relief*, Dina ElBoghdady, WASHINGTON POST (July 22, 2014), *available at*, http://www.washingtonpost.com/blogs/wonkblog/wp/2014/07/22/why-you-may-be-paying-for-someone-elses-mortgage-relief/

AMI represents the managers of mutual funds and money for state and local pension and retirement funds and for a range of public institutions, including unions, teachers, and first-responders, on a daily basis. We stand firmly behind the principle that parties sued by the government or third-parties should not be able to settle with assets they do not own, namely other people's money. The retirement security of the innocent parties whose money we manage could be harmed if these settlements follow recent precedents, in which major bank-servicers were allowed fulfill their settlement obligations with other parties' investments in mortgage-backed securities.

Investors from Mainstreet and Beyond Oppose the Justice Department's Recent Defective Servicer Settlements' Process and Methodology

AMI members are among the institutions who suffered through the actions of the bank-servicers under investigation for their role in developing faulty, poor-quality mortgage-backed securities. Hence, the settlements thus perversely twice penalize the investors and their fiduciaries. AMI members, as fiduciaries for our partners who were never involved in any of the alleged misconduct, stand against any such legal defective settlements (*vis-à-vis* paying settlement obligations with other people's money). While the present hearing focuses on the most recent bank-servicer settlements, we wish to highlight how they build on other past defective settlement precedents. Based on these past precedents, such as the National Mortgage Settlement, these new defective settlements continue to risk the retirement security of numerous innocent parties who will likely be harmed by shifting the settlement costs to these parties and away from the party alleged to have performed the bad acts. The settlements' deleterious effect on American's retirement security is evidenced within the most recent reports by the National Mortgage Settlement Monitor.[3] The Monitor's March 2014 report illustrates that of the $20.7 billion in relief, the largest percentage of the relief (37%) came from first-lien principal forgiveness, which disproportionately

[3] https://www.jasmithmonitoring.com/omso/reports/final-crediting-report/

falls on investment trusts, and hence seniors and retirement savers.[4] We are advised that the most recent DoJ settlements offer even less transparency. AMI seeks a common-sense approach to protect American's savings in light of the continued assault on retirement security assets in the name of punishing bank-servicers for consumer relief.

The primary mission of AMI members is to invest on behalf of our clients, including American investors, savers, seniors, retirees, unions, and educational institutions. These investors have neither direct control of servicing, nor direct contact with mortgage borrowers. AMI members are contractually dependent upon banks and mortgage servicing companies. Investors have suffered material losses due to the careless bad acts of mortgage servicers. Yet, a non-public process harming millions of Americans should not go forward without full stakeholder consideration.

The noted financial analyst, Laurie Goodman, now of The Urban Institute, cautioned: *"The attorney general settlement scares me a great deal because essentially banks are getting credit for writing down investor loans."* [5]

In recent years, a number of settlements with the Justice Department and state Attorneys General have resulted in the responsible party shifting a portion of the settlement costs to RMBS investors.

- In 2005, Countrywide Financial (now Bank of America) reached a settlement with 44 states to settle allegations of predatory lending made by the Attorneys General of numerous states. The resulting $8.4 billion mortgage settlement was never paid from Countrywide assets. Rather, the financial cost was paid out of the trusts into which the to-be-modified loans were securitized, and thus passed onto the holders of certificates in those trusts, who in turn are the general public.

- In 2012, the National Mortgage Settlement was reached after the strong efforts by state Attorneys General, the U.S. Departments of Justice, and Housing and Urban Development. While this historic settlement was reached with five major servicers, including BoA, once again, much of the settlement has been shifted onto the investors who are certificate-holders in the mortgage trusts.

[4] *See U.S. mortgage bond investors take large hit*, Shahien Nasipour, FINANCIAL TIMES, (Nov. 15, 2012) (The FT reporting states that first-lien mortgage investors paid 60% from the BoA portion of the settlement and "slightly less than half" of the JPMorgan portion of the settlement.)

[5] http://www.dsnews.com/articles/first-and-second-lien-holders-to-share-losses-equally-through-settlement-2012-03-16

> News reports explain how billions of the relief has come from investors, rather than the bank-servicers, including our partners such as public pensions, unions, and 401K savings plans.[6]

Recent news reports state that the bank-servicers desperately wish to settle to put these past events behind them. As *the New York Times* recently reported:

> *The [Justice Department's] strategy largely traces to Mr. West, [who] is fond of reminding bank lawyers that to be meaningful, settlements must have a huge penalty. Otherwise, one person who has negotiated with him said, they will simply "be the cost of doing business."*[7]

Yet, it is antithetical, if not patently unfair, for any institution to pass its penalty to another party, such as certificate holders such as seniors and 401K savers. These precedents are very troubling for investors and their impact on the general public. These are not unforeseen consequences, but rather an obvious scheme by bank-servicers to evade liability for their misconduct by further abusing their duties to investors. This affects our clients, and in turn the general public, whom are "Main Street." As the authorities now look to any settlement, AMI wishes to highlight the following points that will help ensure that any final settlement serves and does not harm investors and the public.

We note that the goals of a settlement of this nature may be affected on PLS so long as the loss is not borne by investors. For example, the settling party (*i.e.*, the bank-servicer) can forgive principal in order to assist a delinquent borrower by making a cash payment in the amount of the principal forgiveness to the trustee. This, in turn, would get paid to investors in the form of principal, such as a prepayment. In the past, settling parties have forgiven principal for borrowers without making any payment by simply reducing the principal balance owed to PLS investors, which results in a loss for PLS investors.

In contrast, we commend the action taken in December 2014 by N.Y.S. Department of Financial Services Superintendent Benjamin M. Lawsky. In connection with a non-depository bank servicer action,

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[6] In one instance, a bank servicer has reported more than $7 billion in relief from the modification of first-liens. Accordingly, a majority of this relief comes from mortgage investors whom were never consulted during the negotiations. *See*, http://newsroom.bankofamerica.com/press-kit/bank-america-national-mortgage-settlement

[7] *Bank of America Mortgage Settlement Is Said to Be Deadlocked*, N.Y. TIMES (June 11, 2014) at B1, available at: http://dealbook.nytimes.com/2014/06/10/bank-of-america-mortgage-settlement-is-said-to-be-deadlocked/?_php=true&_type=blogs&_r=0

a settlement was reached with a major servicer as part of a long-standing investigation. Naturally, Superintendent Lawsky had the temptation chosen by other politicians, namely, announcing an inflated big-dollar settlement headline based on faulty-math and harming investors and savers. Rather, he wisely chose not to fleece investors and everyday savers.[8] In conclusion, through Superintendent Lawsky's responsible actions, N.Y. State consumers received more than $150 million in meaningful "hard-dollar" relief including restitution and housing, foreclosure relief, and community redevelopment programs supporting New York's housing recovery.[9]

Another settlement defect has come to light. Hence, in the event that conditions underlying such a settlement materially change, the settlement terms should be re-visited. For example, a recent settlement contained a term relating to a large dollar value attributed to mortgage debt-forgiveness tax relief for the bank. Subsequently, Congress retroactively passed this tax relief legislation (which was foreseeable by many observers). Hence, one can say that the bank now has obtained a windfall. Accordingly, these settlement proceeds should either be clawed-back or reprogrammed in a way to help consumers directly. Otherwise, the party is avoiding the meaningful penalty envisioned by DoJ officials.

Steps Necessary to Remedy the Bank-Servicer Settlement Process

We urge that any settlement must not allow bank-servicers to meet their obligations by performing their duties to investors any differently or by using mortgages managed by them but which they do not 100% own (*e.g.,* own or otherwise are assets owned by the servicer or an affiliate on their balance sheet) as part of such settlement. Additionally, we ask that as part of Congress' oversight the following reforms be instituted:

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[8] http://blogs.wsj.com/moneybeat/2014/12/22/bond-investors-heart-lawsky/ (Lawsky "did not tap investors to pay some of the settlement's costs.")

[9] http://www.dfs.ny.gov/about/press2014/pr1412221.htm

- The Settlement Monitor should make public reports available on a periodic basis, reporting progress on clearly defined benchmarks and detailing whether any remedies are made using trust assets;
- Investor stakeholder participation must be part of any process that will ultimately impact investors. Investors, teachers, seniors, pensioners, and the general public are important stakeholders in any settlement. Yet, investors have never been consulted about the impact of the remedies which have been accepted by various government agencies in the past; and,
- Finally, we ask that we be included in any negotiations from this point forward to make sure our economic interests are protected and not sacrificed by the parties the government has charged.

AMI has been on-the-record as supporting a settlement of claims against the mortgage servicers, as long as it does not harm average Americans, their 401Ks savings, as well as government employee savings programs (*e.g.*, the Thrift Savings Plan system). This means any settlement must be appropriately designed to address such alleged wrongdoing while not hurting innocent parties. AMI supports long-term, effective, sustainable solutions to the housing foreclosure crisis. It is generally supportive of a settlement if it ensures that responsible borrowers are treated fairly throughout the foreclosure process; while at the same time providing clarity as to investor rights and servicer responsibilities. The ultimate settlement should ensure that our clients, who were not involved in the alleged activities and, who likewise were not a participant in any negotiations, do not bear any of the cost of the settlement.

Specifically, bank-servicers should only receive credit for modifying mortgages which they own 100% and not those owned through MBS by third-parties which are often pension plans, 401K plans, endowments and "Main Street" mutual funds. To do otherwise will damage the MBS markets further and limit the average Americans' housing affordability and availability opportunities for generations to come.

Conclusion

Thank you for the opportunity to share the views of the Association of Mortgage Investors (AMI) with the Subcommittee. Please do not hesitate to use the AMI as a resource in your continued oversight and crafting legislative solutions concerning the many issues under review. We welcome any questions

that you might have about these settlements, mortgage servicer abuses, housing finance, securitization, or other mortgage industry topics.